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Royal Commission on Banking and Finance

THE CANADIAN MANUFACTURERS' ASSOCIATION

Hearings held at

OTTAWA

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ROYAL COMMISSION ON BANKING
AND FINANCE

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Hearings held at Ottawa, Ontario, on Tuesday, September 18th, 1962.

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THE COMMISSION

The Honourable Dana Harris Porter
Chief Justice of Ontario
Toronto, Ontario - Chairman

Mr. W. Thomas Brown, M.B.E.
Investment Dealer
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.
Banker
Toronto, Ontario

Mr. Gordon L. Harrold
Agriculturalist
Calgary, Alberta

Mr. Paul H. Leman
Corporation Executive
Montreal, Quebec

Mr. John C. MacKeen
Corporation Executive
Halifax, Nova Scotia

Dr. W. A. Mackintosh
Vice-Chancellor
Queen's University
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--- At 2.00 P.M. the hearing resumed.

SUBMISSION OF

CANADIAN MANUFACTURERS' ASSOCIATION

APPEARANCES

C. A. Pollock	-	President, The Canadian Manufacturers' Association, President, Dominion Electrohome Industries Ltd.
H. Roy Crabtree	-	1st Vice-President, The Canadian Manufacturers' Association, Chairman and President, The Wabasso Cotton Co. Ltd.
George H. Dobbie	-	(Chairman of the Delegation) President, Dobbie Industries Ltd.
H. K. Collinge	-	Vice-President, North Western Pulp & Power Ltd.
W. Hugh Flynn	-	Ontario General Manager, Canadian Industries Limited.
D. G. Keaveney	-	Vice-President and Treasurer, John Inglis Co. Ltd.
W. S. Rothwell	-	Vice-President and Treasurer, Abitibi Power and Paper Co. Ltd.
John M. Thompson	-	Vice-President & Treasurer, Howard Smith Paper Mills, Ltd.
J. Graeme Watson	-	President, E. & S. Currie Limited.

APPEARANCES (cont'd)

L. F. Wills,	-	Vice-President & General Manager, Honeywell Controls Limited
J. C. Whitelaw	-	Executive Vice-President & General Manager, Canadian Manufacturers' Association
W. D. H. Frechette	-	Manager, Commercial Intelligence Department, Canadian Manufacturers' Association
H. Potter	-	Economist, Canadian Manufacturers' Association
C. Willis George	-	Ottawa Representative, Canadian Manufacturers' Association

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THE CHAIRMAN: I will now call the meeting to order.

This afternoon we have the submission of the Canadian Manufacturers' Association. I may say that we have all read your brief with very great interest indeed, and we appreciate the very interesting matter that it contains and also the fact that a tremendous amount of work must have been contributed to the assembly of this information and the writing of this very valuable document.

I do not know, gentlemen, whether it has been decided that some statement should be made before we ask questions on this brief, or whether we should proceed to ask questions immediately. Mr. Pollock?

MR. POLLOCK: Honourable Dana Porter and

gentlemen members of the Royal Commission on Banking and Finance: Mr. H. Roy Crabtree, the first vice-president of the Canadian Manufacturers' Association, and I are very pleased to be here accompanying our delegation to advise your Commission, which is studying banking and finance, as far as the interests of the manufacturing industry are concerned, and to submit the brief and appear before you.

These gentlemen have worked as a group and as individuals, and have studied the manufacturing industry's interests in banking and finance, always keeping in mind, of course, the economic good of Canada. They have spent a great deal of their own time in doing this, and they have also consulted with the Canadian Manufacturers' Association membership, and they have used, very effectively, the most efficient staff of the Canadian Manufacturers' Association under the general managership of Mr. Whitelaw, our executive vice-president and general manager.

It is my privilege, gentlemen, to introduce our group to you. I believe you have a seating plan too, but I would like to introduce each member of our delegation, and as I read his name will each member please stand so that he may be better identified.

Mr. George H. Dobbie, who is chairman of the delegation and president of Dobbie Industries Ltd., Galt, Ontario; Mr. H. K. Collinge, vice-president, North Western Pulp & Power Ltd., Hinton, Alberta; Mr. W. Hugh Flynn, Ontario general manager, Canadian Industries Limited, Toronto, Ontario; Mr. D. G. Keaveney,

vice-president and treasurer, John Inglis Co. Ltd., Toronto, Ontario; Mr. W. S. Rothwell, vice-president and treasurer, Abitibi Power and Paper Co. Ltd., Toronto, Ontario; Mr. J. Graeme Watson, president, E. & S. Currie Limited, Toronto, Ontario; Mr. L. F. Wills, vice-president and general manager, Honeywell Controls Limited, Toronto, Ontario; and Mr. John M. Thompson, vice-president and treasurer, Howard Smith Paper Mills, Ltd., Montreal, Quebec.

I would then like to introduce several members of the Association staff. First of all, Mr. J. C. Whitelaw, executive vice-president and general manager of the Canadian Manufacturers' Association; Mr. W. D. H. Frechette, manager, Commercial Intelligence Department, Canadian Manufacturers' Association; Mr. H. Potter, economist, Canadian Manufacturers' Association; Mr. C. Willis George, Ottawa representative of our Association. Then, Mr. H. Roy Crabtree, first vice-president, The Canadian Manufacturers' Association, chairman and president of The Wabasso Cotton Co. Ltd., Montreal, Quebec; and myself, president, The Canadian Manufacturers' Association, and president, Dominion Electrohome Industries Ltd., Kitchener, Ontario.

We of the Canadian Manufacturers' Association are sure the deliberations which you gentlemen have been carrying on for some time will result in very interesting and important findings; and we look forward to the presentation of your final report.

It is now my pleasure to hand over to Mr. Dobbie, who is the leader of our delegation. Mr. George

H. Dobbie.

MR. DOBBIE: Mr. Chairman and honourable members of the Commission: it is a great pleasure for us to be here this afternoon and to have the opportunity of presenting our views to you. Manufacturers, along with other members of the community, have been following the reports of these hearings with great interest. Undoubtedly, the Commission's inquiry is one of the most important occurrences in our national life in a long time.

Some of the matters before the Commission have been of interest to the Canadian Manufacturers' Association for a considerable period, and the Association was prominent among those advocating the establishment of such an inquiry.

It should be explained at the outset that while the Association views the whole of your inquiry as being of great importance, its own interest in making a submission is somewhat selective. We have, in our brief, mentioned chiefly those subjects where there was a definite opinion among manufacturers that some action was desirable or that some action should definitely be avoided. There are, in truth, aspects of the banking and financial system which affect manufacturers in an important way but where there was no cause for comment.

As to some other matters, just as manufacturers believe that industry should be consulted by government and by Royal Commissions when industrial matters are under study, so it believes that when banking and financial

matters are under study there will be many aspects where only those intimately acquainted with banking and financial business will be able to speak with full authority.

In filing its brief with the Commission the Association is, of course, making a statement on behalf of manufacturers. Its views were formulated for expression on this occasion after an effort to secure the widest possible canvass of opinion in industry. This effort was co-ordinated by an ad hoc committee on banking and finance, and regional committees, representative of both general and financial management in a wide and varied cross-section of industry. One of the first steps taken was to ask each of the more than 6,000 members of the Association in more than 600 communities from coast to coast for suggestions and criticisms on the subjectsbefore the Commission. This was done with a questionnaire which also asked for a variety of facts about the financial problems of both small and large business, to assist the Commission and the committee in their work. More than 150 industrialists, as members of the various committees involved from coast to coast, took an active part in the preparation of the Association's submission.

We give this background to help show the interest which the Association brings to this subject and to give an idea of the degree of thought, discussion and examination by a wide variety of manufacturers which the submission represents.

You will notice that our brief proper is 22

pages in length. There are also an introduction giving an overall view of the subject and a point-form summary of the recommendations. The remainder of the document is a summary of some of the facts and figures developed in the Association's questionnaire survey of its members, which it is hoped may be of some assistance and interest to the Commission.

There are different forms of experience represented in the Association's delegation where members come from a wide variety of industries and types of firms. While you are, of course, free to address any question to any individual member of the delegation, there are some topics which are more appropriate to one member than another. It might be more effective, therefore, if you addressed your questions to me and I will endeavour to indicate who should reply.

We hope that we shall be able to answer your questions to your satisfaction -- and to ours, I will say -- and contribute something to your investigation of the important matters before you. Thank you, Mr. Chairman.

THE CHAIRMAN: Thank you very much, Mr. Dobbie. We will now proceed with questions.

COMMISSIONER BROWN: Mr. Chairman, I wonder if I might ask some questions of a fairly general nature, which might require fairly particular answers, but before we get down to some of the detailed points. This is on the general hypothesis that the more money you are able to save the more money you are able to invest

because, in general, this is behind the policy that you enunciate -- namely, that you need to have a higher cash flow in order to invest more.

MR. DOBBIE: That is true, sir.

COMMISSIONER BROWN: This makes a reasonable theoretical picture, I think. We all feel that same way, that the more money we have in our pocket the more money we think we are going to spend. Have you some figures to show this, that over the years investment decisions have varied with the retained cash flow?

MR. DOBBIE: I would like Mr. Watson to answer this question. We have given this considerable study, and he will speak for us.

MR. WATSON: Mr. Chairman, I think that perhaps the Commissioner summed it up rightly when he said the more money you have to invest -- not that you will invest, but that you will be able to invest. The thinking of our committee has been that there are two pre-requisites to investment: one is the availability of the funds; and the other is the prospect of profit from the investment. It might be argued that the prospects provide the incentive and the funds merely provide the means. In any event, it seems to us the combination of the two must be present to provide a firm basis upon which constructive investment can exert a stimulating influence on the economy. That is a generality.

As to actual statistics which would show a parallel between the savings and the investment, frankly, I have never seen any.. They may be in existence. Of

course, there have been some very wide parallels that might not be entirely on the point, such as the shrinkage in retained earnings over a period and the dependence we have had to have on foreign capital. Those are general parallels; but as for specific parallels actually pin-pointing from year to year the point and adding up to a sum total of investments of various kinds, someone else in our delegation may have the figures, but I do not think I have seen any compiled with any degree of exactitude. It is more the experience of our various members and the members of this committee and, to a certain extent, logic which lead us to these conclusions.

MR. THOMPSON: I think we should add something. This is only deduction and it is not supported by facts, but I think that anybody in business would recognize the principle that we have two types of investment to make. One is investment to modernize our plant, for cost-reduction purposes, for modest changes in our operations and expansion of our business. These types of investment are generally supported by your own internally generated funds. When you are building a new plant or when a major growth problem is confronting a company, you generally rely on having to obtain your funds from outside sources.

In the day-to-day decisions in any business enterprise you are influenced, to a very real degree, in the extent to which your cash flow is going to be able to support these what I would call day-to-day investments of plant equipment, cost reductions and

other things that are so necessary to keeping you competitive. You do not go to the outside market for those funds. A lot of these investment decisions you make are postponable, and you are not required to make immediate decisions. Thus, if you do not see a satisfactory cash flow to satisfy these requirements, to meet your growing needs for inventoryand other working capital requirements -- if those cannot be provided you will absolutely postpone the number of these first types of investment. That is to say, the day-to-day average requirement every company is subjected to. So I would contend that for normal replacement of equipment, the ordinary expansion that takes place in your business, you do rely on your internally generated funds for that purpose; and to the extent you have those funds available you will make them available, and to the extent you do not see them available you are bound to postpone and delay those obligations.

It has been pointed out to me -- I think I referred to it, but it needs emphasizing -- that with this inflationary squeeze, cost squeeze that we have today, to keep alive we must be constantly reducing our costs, which means automation and modernization of our plant. For a large part of those funds we depend on internally generated income to do so.

COMMISSIONER BROWN: The reason I asked the question was that the Bank of Canada figures would appear to indicate the opposite in the last few years, and I assumed possibly you had some rational explanation

of this and perhaps some figures of your own. The Bank of Canada figures show that in the last five years retained cash flow has been going up and new investment going down. Perhaps there is an explanation of this that fits into your context?

MR. ROTHWELL: May I comment on that? But I think for the past five years the need for business expansion in Canada has been lacking. This may not be true of all businesses, but it is true about my business.

We have gone through a post-war period that lasted up somewhere to 1955 or 1957. During that period industry at large was forever expanding plant. Then, commencing somewhere around the 1956-57 era the foreign nations -- Japan, Germany and others -- became much more serious competitors, particularly in the Canadian export trade. The net result is that for a period of time Canada has had a surplus capacity in many of its industires. That surplus capacity has of itself slowed down, in fact almost eliminated, expansion in many industries.

I think that is the reason why the Bank of Canada's statistics showed this result. I don't think it is deliberately intended. I don't think it is a reflection on the use of internally generated funds. I think it is simply a lack of need to expand plant when you have excess capacity existing, both here in Canada and elsewhere in the world.

COMMISSIONER BROWN: In other words, this is not an immediate problem.

MR. ROTHWELL: This does not relate to the internally generated cash flow. In other words, that is not a reason for the slow-down.

COMMISSIONER BROWN: Is there any general

picture that you can give us about how decisions to expand are made? What rule of thumb is used when you decide you want to expand or to modernize?

MR. THOMPSON: I think there is a rough rule of thumb that is generally followed by many companies. It is only a generalization, and I presume it could be disproved in a number of instances. But it is a rule of thumb, and I think it does have some validity.

It is considered that a well managed company that is going to keep its plant up to date -- I am not now talking about expansion, but about modernizing plant and meeting requirements to cut costs, automation and things of that type -- that you spend about your depreciation money on capital investments in any one year.

Investment decisions for future growth -- in the paper business, let us say, when you put in a new mill -- is made on a strictly realistic basis as to what the profit returns are going to be, and whether the risk involved justifies the capital expenditure. That is an individual study that would have to be supported by the economics in the individual case being studied; and that is carried on exhaustively by every company I know of before it makes its capital decisions.

COMMISSIONER BROWN: I would like to make sure that I understand, in the first place. That is, irrespective of the profitability of the investment of your cash flow resulting from depreciation and

capital cost allowance, you invest that.

MR. COLLINGE: Could I use a specific case? I have in mind a specific company that has a specific project in mind to do, a project that is not tremendously profitable but should add to the over-all profits of the organization. Up to date the organization concerned is spending the bulk of its earned depreciation account on bringing a new plant upt to tip top level of economic performance. As a result, there has been no internally generated fund available for the secondary expansion, which would have a value of perhaps one-tenth of the value of the plant.

The company concerned is quite unlikely to go to the public market, for a number of reasons. This expansion will depend entirely on the availability of internally generated funds. I think this is the kind of thing we do rely on our internal funds for. If you are going to double a big plant, then you should go to the public or seek other sources of development. But it is the small developments that will absorb the depreciation account and some more, which we consider necessary to the health of any normal industrial establishment.

Does that specific case clarify the matter?

COMMISSIONER BROWN: I would also like to get a picture of whether you visualize a rate of return from this investment. This comes to, say, $200,000 in the year?

MR. COLLINGE: I suppose.

COMMISSIONER BROWN: Do you visualize a rate of return from this $200,000, or do you visualize a saving ...?

MR. ROTHWELL: May I try to answer that question?

In the past five years market conditions in Canada and throughout the world have markedly changed. We today put paper back in the beaters that six years ago we would have shipped. In other words, the paper we are putting back in the beaters now would have been an acceptable market product six years ago, but it is unacceptable to today's market.

What has happened is that competition has increased so intensively that anything short of top quality is no longer good enough for the market. In our company we have spent a number of millions of dollars, with no actual investment yield as such attached to it. We have spent money that will increase our manufacturing costs, but if we don't do it we haven't got a product that will sell and satisfy our customers in the market we are in today.

So, every established company has before it a list of absolute musts in its capital expenditure programme. As Mr. Thompson implied, perhaps you can postpone these musts for one year, perhaps two years, but you cannot postpone them very long, because if you do, you are going to have a product second to somebody's product. In the kind of a

market we have today, one of your competitors is always improving and producing a slightly better product, and that is what is going to sell. It is a better product, a quality product.

So, to stay in business you have in front of you all the time a whole series of projects that perhaps add up to millions that must be spent. Now, if they are not done this year they have got to be done next year, and year by year you sort them out. For instance, if you have ten projects, there may be four of them most important and the others can be postponed. So, four you do this year and the other six have to wait. Next year comes along and to the six you already have three more rear their ugly heads, and you now have nine. Out of the new nine you may select four or five that you have to do. This process goes on. In every company every year some major part of the capital expenditure programme comes under the heading of necessity: things that must be done if you are going to maintain your place in the market.

This condition was not particularly true as of 1957; it was not really true from 1945 to 1957. We in industry were actually postponing quality, postponing perfection, because the market did not demand that we do these things. But today's market does demand it. If you are going to survive you must have the best product you can possibly have, and the only way you can get it is by spending money. You spend the money and the net result is

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you reduce profit, but you hold your customers and your volume.

COMMISSIONER BROWN: It is a process of investing in order to avoid losses.

MR. ROTHWELL: That is it.

MR. THOMPSON: It might interest you to have a list of the classifications of expenditure; in every company expenditures fall into different classifications.

We in the Howard Smith organization recognize capital expenditures for cost reduction; that is, it is only related to cost reduction. We will look at the return on the investment to determine whether or not we will make that expenditure. If it happens to be a new product development, we will look at that. We would expect a much higher rate of return because of the risk involved.

Then we have expenditures that carry no hope of return; we call them defensive. They are defensive in that we have to meet the quality of a competitor's product. That is a required expenditure simply to hold what we have.

We have another group which is strictly replacement. If a machine is worn out and it has to be put back in shape again, of course it does not go back at its original cost or in its original form. Unfortunately, the cost is much higher than

criginally, and naturally we get a better machine. But the determination there is not the return.

Then, we have a sort of miscellaneous basket of expenditures providing for offices, facilities for employees, cafeterias and other items that might be laid down to be done by legislation which you have to meet. You cannot measure these in terms of return.

These classifications can be extended,but I have given the categories into which the capital expenditures would fall in most industries. In some there is a return,and others there is no return.

As Mr. Rothwell pointed out, these pressures are not always on you to make them today - they may be postponed. You plan them over a period of time, and the determination with which you meet these requirements depends to quite a considerable extent on your estimated availability of funds from your own resources.

I distinguish these types of expenditures as compared to putting up a brand new mill, or going into a new business requiring very substantial funds for which you would have to go to the market in order to arrange the necessary financing.

MR. DOBBIE: I might mention here, Mr. Brown, that in some companies, especially the smaller ones, their retained profits and depreciation is their only source of funds.

COMMISSIONER BROWN: I think we all agree that the smaller companies are in a special category.

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COMMISSIONER BROWN: I think we all agree

This has been recognized in tax legislation, with the lower rate of income tax on the first $35,000 of profit. So, relative to their profit they have a greater ability to retain earnings than the larger companies.

MR. DOBBIE: I think that is inherent, that they require it.

COMMISSIONER BROWN: Let us leave aside these expenditures that you regard as necessities, that is on which you are going to get no return. On some you have an indirect return in morale. These others, what you classify as defensive, and the others that follow, you are not going to get a return on them, and you make the expenditures well knowing that fact. You mentioned that for the cost reduction expenditure you expected a return; for the new product expenditures, you expect a return. What sort of return? How big a return?

MR. ROTHWELL: I will answer that, if I may. We would look for as an optimistic target 20 per cent before taxes on an expansion. This is a theoretical figure, kicked around in industry, but I think you would get the same answer from hundreds of thousands of people. It is just one of those things -- 20 per cent before taxes.

We will embark on many of these new projects with an indicated return of less than that, but I don't think we would embark on one at very much less. We might go as low as 14 per cent, but that is about it. Then we would want other considerations

in the picture. It is not just the return that comes into the picture. Is this thing going to stand five years from now? Who else is going to be around five years from now? How does this operation look? Perhaps the planning of it. Perhaps the fact that we do it now offers advantages that will offset a relatively low rate of return. But the common standard discussed in industry is 20 per cent before taxes, or if you like, 10 per cent after taxes. But industry does make investments and embark on expansion programmes that offer less than that.

MR. THOMPSON: I would agree.

COMMISSIONER BROWN: Would that apply to cost reduction?

MR. THOMPSON: It would change your rate as you along, or give a smaller return. Rather than take a minimum rate of 20 per cent for new product development, you might want 30 or 40 per cent, bearing in mind the risk involved, the market conditions and what you know about it.

COMMISSIONER GIBSON: Have you not one common principle, whether for defensive or cost reduction expenditures, namely, that you get a maximum return on your total investment capital, looking ahead over the future? Even with defensive expenditures, do you not try to do that?

MR. THOMPSON: We have to have a higher return on these specific items to make up for those items do not give a return.

COMMISSIONER MACKINTOSH: May I clarify that, with respect to competitive items: you are not expecting to make a profit over and above your present position, but you are making them in order to avoid losses?

MR. THOMPSON: To avoid loss of business.

COMMISSIONER MACKINTOSH: To avoid loss of business and loss of profit. So, in effect you are expecting to make a profit on them over and above the profit which you would have had if you did not make them. While it is hard to figure on the return of profit on the particular project, nevertheless, the undertaking of these expenditures will, you think, raise your total profit above what it would be if you did not make them. So, they are not in kind different from the others, but they are a little different in their immediate character.

MR. THOMPSON: Yes. As you say, we are making a profit if we prevent having a loss.

COMMISSIONER BROWN: This is what you are trying to meet.

COMMISSIONER MACKINTOSH: Most people work as hard for the one as for the other.

MR. THOMPSON: There is a saying in business today -- we have to run very hard to stand still.

MR. DOBBIE: To clarify the matter of expenditures about which we have been talking, the Association's survey of its members last year the average profit last year was 7.6 per cent of net worth.

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That is in 1961.

MR. FLYNN: I think it might be pointed out that ten years ago it was something over 14 per cent. So, in spite of the money spent by industry to hold its own, so to speak, for various reasons our profits were halved in the last ten years.

COMMISSIONER BROWN: Again, if you go back to the Bank of Canada figures, I think you find it is less than that over the whole picture of business investment.

Now, would you be prepared to discuss in general terms the advantages of expansion through retained earnings as against the suggestions that have been made in other places. In other words, where emphasis is placed on the profitability of new investment and has to be sold, rather than an internal board of directors?

MR. ROTHWELL: May I try to answer that?

If you will permit me to be simple at the outset, I do not believe that industry is anywhere near as scientific as most people think it is. I liken the financial problems of industry to the financial problems of the household. I don't think they are materially different in principle. The problems that exist in a household exist in industry; true, in a big company they are magnified, and there are more of them, they are more complex and require more skill, but the basic principles are there.

In a man's household he undertakes debts,

That is in 1961.

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COMMISSIONER BROWN: Again, if you go back to the Bank of Canada figures, I think you find it is less than that over the whole picture of business investment.

Now, would you be prepared to discuss in general terms the advantages of expansion through retained earnings as against the suggestions that have been made in other places. In other words, where emphasis is placed on the profitability of new investment and has to be sold, rather than an internal board of directors.

MR. ROTHWELL: May I try to answer that? If you will permit me to be simple at the outset, I do not believe that industry is anywhere near as scientific as most people think it is. I liken the financial problems of industry to the financial problems of the household. I don't think they are materially different in principle. The problems that exist in a household exist in industry; true, in a big company they are magnified, and there are more of them, they are more complex and require more skill, but the basic principles are there.

In a man's household he undertakes debts.

for example, probably for the first time when he buys a house. He borrows the maximum allowed on that house, and he has to somewhere find the difference. Then, over a period of a dozen years or more he has the house paid off, and it is his. He may at that stage decide that he is now ready to have his second house. He takes the equity out of the first house and buys another. Again, he incurs debt. In turn, he pays that debt off. A business operates exactly the same way. We don't like debt any more than the householder does. We are better off, as the householder is, if we can build a wing on a plant, or a wing on the house. We are more prudent, more thrifty and more sensible if we can build that wing on the building from retained earnings. To imply, as has been implied before this Commission, that we should be forced to go to the market-place to borrow money to put that wing on the house, or something like that, I couldn't disagree more. It is like saying, if you are going to buy a new car you should not save up the money in advance to buy it, that you should of necessity go to the finance company and finance the new car, because they are standing by waiting to serve you.

The same is true of the householder. He manages his affairs to the best of his ability, and within reason, avoids debt. I don't think industry is afraid of debt, but industry should have good reason for debt, and a good reason generally means major expansion. So, industry then much prefers

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to finance by internal cash generation.

Now, if industry was to take on debt, it is automatically policed on debt repayment. Perhaps you will know very well that the investment dealer through whom you are working, and other people, in effect lay down a programme of debt repayment, and if this programme of debt repayment is not sound you cannot float that debt.

So that when you undertake debt you also undertake debt repayment, just like a man who borrows to buy an automobile,and you may not know whether that debt repayment will not hamper your activities in the future, so if you can handle your business with internal cash generation this is what you should do. You save your borrowing power for major expansion programmes and, speaking of my own company, Abitibi, a few years ago our debt ratio went between 35 and 40 per cent. Today it is between 21 and 22 per cent.

This is not a deliberate attempt on the part of management to reduce that debt ratio, it is simply indicative of the times we are in. We wouldn't hesitate to increase our debt for a worthy and reliable cause, but in the kind of market we are in it has got to look pretty good before we will undertake debt to do the job, so that there is no question that the industry which prefers to finance its own expenditure from internally generated funds -- there is no question but that that is the prudent and thrifty thing to do, and my comparison to the household I think is quite fair.

COMMISSIONER LEMAN: Are you telling us that, in fact, manufacturers when they use internal funds to finance something, to buy machines or to make alterations, or for a limited investment decision---

MR. ROTHWELL: They would never get out of debt otherwise.

COMMISSIONER LEMAN: Does this mean that they have a tendency on the average to figure that these

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COMMISSIONER LEMAN: Does this mean that they have a tendency on the average to figure that these

funds cost them nothing; they don't ascribe the cost in testing the value of that investment?

MR. ROTHWELL: No, the funds certainly cost them something because these funds could be otherwise employed in even the short term money market. Industry doesn't have the funds lying idle. We have lots of funds out today and we are earning 5½ per cent on them and on 90-day money, and I think when we come to use our internally generated funds we have to look at the use as opposed to what they will earn and as opposed to being simply funds, but I think that industry is hesitant to take on debt if it can avoid debt, only because debt must be repaid. It is not something you can just leave in the air forever. When you take on debt you have to take on a repayment schedule with it as a general rule.

COMMISSIONER BROWN: And does this imply you are prepared to do something more risky with the internal funds and you have to study it much more carefully when you go outside?

MR. ROTHWELL: I think that is generally true, without me being too specific on the subject. I think you will spend internally generated funds a little sooner.

THE CHAIRMAN: The situation is a relative situation, is it not; there are certain expansions that occur from time to time, but perhaps not regularly?

MR. ROTHWELL: That is right.

THE CHAIRMAN: On which you borrow money in perhaps a big way, but there are certain expenditures

that recur from year to year?

MR. ROTHWELL: Yes, always.

THE CHAIRMAN: So that you have almost a level which makes it an increased level of expenditure which you incur from year to year; it is not always for exactly the same items, but various items and some of them might be of a capital nature on a smaller scale and some not of a capital nature at all, but for that sort of thing the thing you use is the matter of prudent practice and you would like to pay for that out of your annual ---

MR. ROTHWELL: And save your growing capacity.

COMMISSIONER LEMAN: We are talking about expansion, are we not, expanding the plant?

MR. COLLINGE: We are talking about expansion in a very small way. We are talking about maintaining the market position, which is not expansion but which is a loss proposition as far as a company is concerned, and day-to-day replacement of machinery. These are the things that I think the Committee has clearly said is the need and demand for internally generated funds.

COMMISSIONER BROWN: But your contention on this is that the present regulations do not permit you sufficiently --

MR. COLLINGE: That is the general feeling of the Association, I think.

MR. ROTHWELL: I think without question. If I can quote a couple of figures, and I didn't really -- I just developed this yesterday to see how it looked, but

our company spent on capital investments over the last eleven years -- these are public figures and were taken out of our annual reports -- slightly better than $125 million. Our income taxes during the same period of time were $148 million; in other words, our income tax burden exceeded our capital expenditures, and, as a company, that $125 million figure does include considerable expansion.

During that same period of time we borrowed $45 million, but we repaid on our borrowings $41 million, so that on balance our borrowings virtually stood still.

Now, that is first mortgage debt and debenture borrowing; that is debt borrowing, so we virtually stood still, but what I am getting at is any time the tax burden exceeds -- that is, the income tax burden -- exceeds the capital expenditure flow in an expanding company, it must be quite a burden. I don't think it is up to us to say how much of a tax burden industry can handle, but we do point out that the one we have is quite serious.

COMMISSIONER BROWN: Will you give us your figures for the cash flow?

MR. ROTHWELL: No, I can't.

COMMISSIONER BROWN: Presumably it was sufficient to take care of everything?

MR. ROTHWELL: I would say our cash flow in that same period of time -- if I may use an approximation -- would be $240 million.

COMMISSIONER BROWN: After dividends?

MR. ROTHWELL: Before dividends, and the

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dividend flow -- that would be before dividends and after dividends I would say it would be $150 million.

COMMISSIONER BROWN: So, your cash flow took care of your capital expenditure in the period?

MR. ROTHWELL: That is right, and also there was debt repayment going on. They also reduced our preferred shares in that period of time quite considerably, so that our cash flow was necessary for debt repayment; it was necessary or we devoted it to retirement of preferred shares and for other purposes.

COMMISSIONER BROWN: So, in your case your cash was sufficient to take care of your requirements?

MR. ROTHWELL: Oh yes.

MR. COLLINGE: Would it not be better to ask the question the other way around? Apparently you spent all the available cash on this; could you have spent more and would you have spent more?

COMMISSIONER BROWN: We note, then, that there was a lot of money lying idle -- at 5 per cent!

MR. ROTHWELL: But we had endless projects on the books which had an influence, and another point is working capital, and maybe you are thinking of cash flow and what it does. Have you ever realized that industry needs greater and greater working capital every year and it can only come from two places; again borrowing to provide working capital or from internal funds.

COMMISSIONER GIBSON: As a person with a banking background, I sympathize and agree with your need or desire not to be in debt, and your desire to

finance as much as you can out of cash flow, but I was intrigued with the analogy that you made between the company and the household, because one of the quite widely spread ideas on this continent is that the effect of consumer finance borrowing, in order to get things quicker, is to produce greater incentives to work harder and to work longer, and so on and so forth, and this is supposed to give our economy a bit of an extra spark. Now, I am not saying I agree, but I am giving you the theory. Do you want to carry your analogy through to industry? Maybe the desire to get out of debt is a good stimulus and therefore perhaps borrowing in the market isn't such a bad thing at times?

MR. ROTHWELL: No, I quite agree, but there are a lot of major companies in Canada that are debt free. I happen to be associated with a company that is not debt free. We have carried a rather heavy debt burden. In fact, sixteen odd years ago the debt burden looked like it was maybe too much for the company. We are very debt conscious but we are not afraid of debt and I am quite sure that given a worthy project we would be willing to take on the debt tomorrow morning, but with this kind of market we know it is rather difficult to find these projects.

COMMISSIONER GIBSON: I was thinking of the question of a stimulus to efficiency. Are you more likely to be on your toes and press to improve your position than if you were not so in debt?

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COMMISSIONER BROWN: I was going to say that there are some people who have a different point of view on this financing of projects who would carry your analogy of the family just a little further and say if you would go to the point of saying that the family income is to be divided up among the members of the family and the family decide whether they would buy a new car or a washing machine, that they would go along with you.

MR.ROTHWELL: I have heard this, and for those people who employ that it is a proper and natural thing to do to raise the money on the market, but I say to them that when they bought their last automobile did they pay for it out of savings or did they go and finance it through a finance company, and many of them have told me that they paid for it out of savings. Well, I think the same will hold true in business.

MR. FLYNN: Could I comment on this? It seems to me that this question of who is to be the judge of an expenditure, I think we would feel that management is in a better position as it has to account to its shareholders for what it does.

MR.ROTHWELL: If I might interrupt, and pardon me for talking so much, but the atmosphere here is so friendly and informal that I just can't stop trying to take over.

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I have a statement here that we at C.M.A. would like to read into the record. So, if you will bear with me, it will take me all of two minutes. This is by Professor William C. Hood and it is from the book entitled, "Financing of Economic Activity in Canada" and it deals with the subject, and I quote:

> " The decisive argument however in defence of firms financing their expansion with their own saving against the charge of possible misallocation of resources is, however, that the ultimate test of investment decisions is whether the funds invested have been used profitably. This test must be passed by all firms whether they secure their funds from their own operations OR in the capital market. It is indeed an expost test but it is the only final and conclusive one there is. But the test is continuously applied. Firms cannot long fail to meet it and survive. Unprofitable companies will not find it easy to raise funds in the capital market; unprofitable companies will not long be able to finance expansion from depreciation allowances. In short, profits are necessary to the obtaining of funds for expansion whether directly or indirectly; they are the reward for success and the licence to try again. In a growing, advancing economy in which some firms are leading and some

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"lagging, the ultimate equilibrium of 'normal' profits for all survivors is never attained. We have only a rough test as to whether resources have been allocated in the proper channels and that is the test whether firms can use their resources profitably. This test must be passed by all firms if they are to survive, irrespective of whether they draw their funds from their own saving or the saving of others."

Thank you.

COMMISSIONER BROWN: I suppose one should also include in that the statistics that show that the investments in 1950 were 9.1 billion after depreciation and in 1959 they were 20.1 billion, and that income, before taxes, had risen from 1,308 million to 1,570 million for a net return of 2.4 per cent before taxes. These figures are for manufacturers.

MR. ROTHWELL: They must be correct.

COMMISSIONER BROWN: Those are all the questions I have on the general points, Mr. Chairman, but maybe some of the other Commissioners have something they wish to carry forward.

THE CHAIRMAN: There is one aspect of this problem that strikes me. I may not be quite right about this, but if you have retained earnings, you have the money there, and if you decide to spend it on something that is somewhat speculative -- that is,

maybe in the time of a recession when you may not be sure that it will make a return or might lose some of that money -- nevertheless you might decide to use that money, whereas if you have to go out and borrow that money and you are faced with the possibility of paying interest on something that disappears in a few months, you wouldn't take that risk?

MR. FLYNN: Correct.

MR. COLLINGE: In other words, the expert in business knows the risks he takes with the shareholders' money, but if he is going to borrow on the market he puts himself, perhaps, in a position of real jeopardy with everything because he has got to meet interest.

THE CHAIRMAN: You can afford to lose the money in hand, but you can't afford to lose the money you have borrowed to the same extent?

MR. COLLINGE: This is particularly true in the small enterprises.

COMMISSIONER LEMAN: Of course, when we talk about raising capital in the market we don't necessarily think only of debt securities.

MR. ROTHWELL: No.

COMMISSIONER LEMAN: It could be raising equity, too.

MR. ROTHWELL: Yes.

COMMISSIONER LEMAN: Well, Mr. Chairman, if I might turn to the original sequence, to what we were talking about, the fact is that every large manufacturer would like to have a high proportion of the

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I might turn to the original sequence, to what we were talking about, the fact is that every large manufacturer would like to have a high proportion of the

capital requirements from retained earnings but they can't always do so. First of all, because sometimes they do tackle expansion that is too large to meet from those retained earnings, and, secondly, because people have to start some time in business, they haven't always been going for many years, and in your brief you have made an attempt at analysing what has been the fate of a manufacturing industry in the capital market through this questionnaire which you have sent to your members.

Now, there is a reference on page 41 to the experience related to companies who have applied for term loans, which seems to indicate that larger companies have been more successful than small companies in obtaining term loans, and there is a more detailed analysis of this in Table 4 at the back of your brief. This is referring to term loans through chartered banks.

Now, on the whole what conclusion do you draw from the results of this questionnaire. Is it mainly that small companies have more difficulty in this field than large companies?

MR. POTTER: Yes, that would be true. It is not possible to draw very extensive conclusions. There may have been good reasons why these people who applied for term loans could not get them, but it may point to a deficiency in the facilities. There is no of telling from the survey. It has a very limited story to tell us. It does support or tend to prove what, in a certain sense, was known already, namely, that a smaller business has special problems, but it does not say what should be done.

COMMISSIONER LEMAN: But this is the main inference that can be drawn?

MR. POTTER: Yes, it does seem to show that.

COMMISSIONER LEMAN: Then, there is another reference in paragraph 187 to a broader sort of question, and that is also supported in more detail by some tables at the end. You were then asking a simple question: Do you have sufficient short-term capital, and do you have sufficient long-term capital? It looks as though, again, the smaller companies seem to suffer from a lack of sufficiency of both types of capital, but especially long-term capital. That is also the inference to be drawn from the answers to that particular question?

MR. POTTER: Yes, that is correct. I suppose

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MR. POTTER: Yes, that is correct. I surmise

the comparison between the position of the smaller companies with respect to short-term capital and long-term capital is what one would logically expect. The risk is greater with the long-term capital. With the short-term capital there is the possibility of giving a suitable form of security. The problem of risk would loom a little larger in the long-term capital. Again, it is not possible to say whether these are companies that could not meet a test of worthiness for obtaining capital on any basis, or whether they are companies that are not receiving adequate attention under the present facilities.

As is noted in paragraph 188, there will be a varying ability of respondents to absorb extra capital, but, again, it is impossible to determine that. It just directs attention to this and seems to support what is generally believed to be a problem area. It does point to the fact that Canadian controlled companies have a disadvantage which is, in a sense, a disadvantage of not being a part of a larger organization.

COMMISSIONER LEMAN: First of all, I think the indications are, from the outline you have given us of how the questionaire was made up, that it did not attempt -- perhaps you felt it would be too much of a burden -- to get at causes very much. It asked some very definite questions and asked for "Yes" or "No" answers. Were there areas for comments below each question?

MR. POTTER: Yes, and we got quite extensive

comments which were used by the committee in preparing the brief. There were various viewpoints expressed, and also criticisms, commendations of financial institutions, condemnations of them, and explanations of their own particular situation. It is difficult to put this into an over-all pattern, but many of them were considered by the committee in its recommendations.

COMMISSIONER LEMAN: Did you get the impression mostly that you got very responsible answers from the level of management in each company that was involved in policy? Do you feel that these answers were made by people who knew exactly what the financial policies of the respondents were?

MR. POTTER: Well, the respondents would be the persons responsible for financing, I am sure. I would think that probably the greater percentage would be quite credible answers. We got a few that were somewhat off the rails, I suppose, but to a great extent they also amplify what is already known, that small business does have these difficulties. You get some of these comments embodied in section on the Industrial Development Bank, and there is one specific area. Also with respect to some of the comments in regard to term loans from banks. We know as a fact that there is widespread comment to the effect that the manufacturers would like more dependable credit and somewhat longer credit than the sort they get from banks.

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Development Bank, and also on the fact that the manufacturers want longer term credit, so to speak. That is to say, where they were getting it for 7, 8, 9 or 10 years they now want it for a longer period, and they want such credit more freely available in some cases. There was a great deal of complaint about the red tape and the delays and the cost of credit as a result of ---

COMMISSIONER LEMAN: But were you able to ascertain, from the way the questionnaires were answered and as soon as it became apparent that small firms have greater difficulty than large firms, whether it was just straight availability, or whether it was a matter of avilability at a certain cost?

MR. POTTER: I think the major emphasis was on availability. There were numerous complaints about cost which would suggest that some of the projects might be marginal. Some people thought that the costs of credit at the Industrial Development Bank and at the chartered banks were too high, although I do not think that is considered high cost credit. We did not attempt to follow it up from that standpoint.

COMMISSIONER LEMAN: I am trying indirectly to ascertain how much importance you attach to the response you got to your questionnaire, because if you observe this general conclusion that small firms have more difficulty than large firms you must look for the causes of this. Since there is not much comment in your brief as to the causes

for this one would have to look at what you feel the causes might have been by looking at the recommendations you make -- the recommendations contained in your brief that bear on the subject. There is a list at pages 30 to 34, and some of that list have nothing to do with this question, and we should, therefore ---

MR. POTTER: Well, the members of the delegation are the spokesmen for the Association on the policy, but if I may, to a limited extent, explain the link between these recommendations and the survey I will say there was a feeling that the problems of small business are more acute than those of large business, generally speaking, and the means needed to meet them were much the same.

For instance, I note that it was felt that Recommendation No. 4 about income taxes and depreciation would be of special assistance to small business since small business is so extensively dependent upon internal funds because it has a difficulty in getting external funds in many cases. The recommendation for mortgage lending by banks on the security of equipment and real estate, though such lending is not to be made at the same rate of interest that is charged on other loans, is also made to meet this need for long-term financing for small business. There are other reasons behind it relating to manufacturing more generally, but this is, I think, in a sense an alternative to asking for more government money for that purpose.

Generally speaking, there is the problem of the cost of obtaining funds externally to small business so that wider availability of mortgage funds would probably be of more practical importance to small business than to large business.

COMMISSIONER LEMAN: That is Recommendation No. 8 -- mortgages from banks?

MR. POTTER: Yes.

COMMISSIONER LEMAN: Recommendation No. 9 concerns the "basket clause". That would not be of particular significance in this discussion of small business versus large business?

MR. POTTER: No, except that if that existed now there might have been a broadening of bank loans to small business. That is purely speculative. It is more a matter of principle, I suppose, than having any concrete relationship to a definite and specific problem.

Recommendation No. 10 may relate to small business in so far as small business in outlying areas has special problems. One comment that was made by a respondent in the Prairie Provinces was that small business gets its risk capital from individuals who have money for that purpose -- well-to-do individuals who want to take risks on the sort of venture that cannot be financed in the market. He commented that in metropolitan centres or the more central areas these individuals with risk capital, to be approached individually, are more plentiful, but they are just not available in the smaller areas.

So, Recommendation No. 10 is a matter of principle rather than having relationship to a specific complaint or something of that sort, and it would also have a relationship to small business.

Recommendation No. 11 is also related to small business quite obviously and pointedly because it mentions it there.

COMMISSIONER LEMAN: Factoring is likely to be of more help to relatively small firms than to large firms, but you use that reference to factoring in a negative way. You seem to imply that it is a symptom of an inadequate supply of credit in Canada which can be explained by the fact that the banks are not supplying sufficient short-term credit.

MR. POTTER: I think there were two different views taken of this by members of our Association, and both the views are embodied in the brief. There may be inadequate supply of bank credit. There was also the viewpoint expressed that factoring was a good thing. It may have both aspects, of course.

COMMISSIONER LEMAN: Recommendation No. 12 refers to lowering the cost of public financing.

MR. POTTER: That would not bear on very small business, but it would have an impact on the lower threshold of companies considered in terms of size and their ability to do financing publicly. In Recommendation No. 13 we say: "This would be of benefit to all companies offering securities". It

would also, one would think, tend to increase the size threshold of external financing downwards.

Again, Recommendation No. 14 arises in quite a definite way from the questionnaire. There are these complaints by manufacturers, and they are brought to the Commission's attention. They were actually quite voluminous, but they repeated the same themes to quite an extent which, of course, underlies the concern some of these matters are to small manufacturers.

I suppose that Recommendation No. 15 might have at least some limited effect in the long run on medium-size Canadian owned firms, and remedying the sort of complaint that has developed in the questionnaire, but it is not possible, of course, for us to say how much.

Recommendation No. 16 has a relationship to small business, quite definitely. This problem of fraudulent bankruptcies is a serious problem where it causes a manufacturer to get into financial difficulties, and it bears quite specifically on the small manufacturer. There was one small manufacturer who said his greatest financial problem was in assessing credit risks. The large manufacturer and the small manufacturer both compete for business on the basis of credit terms, but this problem hampers the small manufacturer more.

So, I think it can be said that although there is not a specific wording in these recommendations relating them to the questionnaire it can hardly

be implied that the results were in any sense ignored. These recommendations would seem to me to meet the complaints developed by the respondents to quite a considerable degree. It is not possible to give answers to all these problems, and, again, it is not possible to say all these people who have problems who are credit worthy, and on that basis it is not possible to judge them.

COMMISSIONER LEMAN: Do I gather that what you look for in regard to this problem is quite a lot of little improvements here and there in the institutions that exist in the actual functioning of the capital market now, but no major change anywhere?

MR. POTTER: Yes.

MR. DOBBIE: I think you can find throughout the whole underlying theme of the brief the idea to broaden the market for money available to manufacturers -- in other words, where they get the money.

COMMISSIONER LEMAN: Yes, but "broadening it" is a very general term. We have to think in terms of specific remedies.

MR. DOBBIE: Yes, but then we come down to specific recommendations of how that could be implemented.

COMMISSIONER LEMAN: I did not want to spend too much time on this, but it is a fact that we have received many representations about the difficulties in the small business field and in the obtaining of capital on reasonable terms. That is why I am anxious to see exactly what, broadly

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speaking, would be your approach to a solution to this problem, and also to see whether you agree with the fact that small businesses are not properly serviced under our present system.

Let us talk about what you say more specifically relative to the banks. There seems to come out of your brief a feeling that the banks' realm of operations should be expanded somewhat. When you talk about mortgaging by banks do you have in mind long-term loans? Would you go so far even as to get them into the long-term financing of industry through these mortgages?

MR. DOBBIE: Yes, on the security of mortgages.

COMMISSIONER LEMAN: Well, there is a suggestion in paragraph 63 of your brief:

> "... it will probably continue to be wise to have the investment powers of banks spelled out legislatively, with any reasonable restrictions so that all may know what role banks are expected to play in the economy."

What are the reasonable restrictions and limitations that you would see? You suggested there should be spelt out by the law. What is the proper role of banks and what should be the reasonable restrictions on banks, to define their role. What do you think there?

MR. DOBBIE: We have said it in reverse, I think. We say the role as it is should be extended to include their power to loan on mortgages plus, we also recommend, a basket clause for their investments. Does that answer your question?

COMMISSIONER LEMAN: Yes, but I am wondering what restrictions there would be if you got them involved in long-term loans with mortgages to industry. You say yourself they are already granting mortgages on housing. Obviously they will continue to grant short-term loans, as they have been, to business for working capital purposes. Would there be any restrictions?

MR. DOBBIE: We say restrictions in this sense: In the above quotation from paragraph 63, "reasonable" should be understood to mean "not objectionable". The brief is not arguing that restrictions are necessary or that they are not. The quoted sentence proceeds on the assumption that the Commission is not likely to recommend, or be asked by anyone to recommend, the abolition of all guidelines defining the role of the banks. Manufacturers' interest in the suggested "basket clause" would proceed simply from the fact that if such a clause existed banks could experiment with new ways of lending

to industry without waiting years for changes like the introduction of mortgage powers for which the Association is asking.

COMMISSIONER LEMAN: What I am wondering is, whether your feeling is the role of the banks would be to take on all-comers and make any kind of loan it wished and to anybody -- business, individuals -- with any security they wished. In other words, you want to open the whole field of lending to the banks?

MR. DOBBIE: We are saying that whatever powers you as a commission recommend for the banks, that they be spelt out so that everybody knows exactly the functions the banks are performing.

THE CHAIRMAN: That is, if we decide to recommend that certain additional lending powers be given to the banks than they have now, that we should also recommend that that be spelt out in a definite way, so there would be no difficulty about it?

MR. DOBBIE: That is very correct, sir.

MR. COLLINGE: There is a spelling out of the loans which may be made under Section 88 of the Bank Act.

THE CHAIRMAN: Do you mean you are not satisfied with that now?

MR. COLLINGE: There is a spelling out there; and why not have a similar one in this instance?

MR. DOBBIE: If you broaden the powers of the banks to lend, plus the basket clause.

MR. ROTHWELL: Without saying how.

THE CHAIRMAN: Do you say anything about the

6 per cent ceiling on bank loans here?

MR. DOBBIE: Yes, we have a few thoughts on the ceiling.

THE CHAIRMAN: I thought there were, but I had forgotten. It is not in the brief, is it?

MR. DOBBIE: No, it is not, sir.

THE CHAIRMAN: That is what I thought. I was trying to recall where I had seen it in the brief.

MR. POTTER: Section 62.

COMMISSIONER LEMAN: I read Section 62 to mean a recommendation that the 6 per cent legal ceiling be removed.

MR. DOBBIE: No, absolutely not.

MR. COLLINGE: The removal of loans to industries against mortgages.

COMMISSIONER IEMAN: Only on mortgage loans?

MR. COLLINGE: Yes.

COMMISSIONER LEMAN: How about on other loans?

MR. DOBBIE: The Association's thought on that is most of our members use bank credit continually or from time to time. This enters into the cost of the product, and we would not like to see the ceiling raised. It also gets into the problem which Mr. Thompson can touch on, and which I will mention very generally, that if the rates are too high it slows down the money industry would be liable to attract. But -- and here we get into the matter of size -- smaller manufacturers say it is basically a matter of availability and not cost. If it came to a point where there was a choice to make, if by paying a moderately

6 per cent ceiling on bank loans here?

MR. DOBBIE: Yes, we have a few thoughts on the ceiling.

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higher rate you got a compensation, in that money was available, this would have to be studied again and we might be able to make recommendations on it.

As to the matter of the actual interest rate and how it would affect industry, Mr. Thompson has a few words on that.

MR. THOMPSON: This is a little apart from this question about the establishment of a maximum ceiling on the bank rate. There were just some general comments we had prepared in relation to the effect of higher rates of interest and the bearing that has on investments. Do you wish me to pursue that in relation to the question you asked me?

COMMISSIONER LEMAN: We would like to cover that a little later.

MR. THOMPSON: I do not think they are relevant, specifically.

COMMISSIONER LEMAN: The 6 per cent ceiling is a restriction on banks today; that is one restriction. Are there any other restrictions, or should there be none other?

MR.THOMPSON: I think, in general, what we say is the more you liberalize restrictions on banks to assist business, the better it is for business and particularly small business. Our banking system is mature today, and even though they have the right to do it, it does not mean to say they are going to be foolish and make bad investments and loans. They are going to use good judgment and they are big boys now and are well able to look after themselves.

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In this broad sense, greater latitude can be granted to our banks than, say, thirty or forty years ago, when there was a larger number and some were weak and small. Under the present banking system we feel that any liberalization in their lending powers would be helpful, particularly to smaller business.

THE CHAIRMAN: You do not think they are mature enough to be trusted with the removal of the 6 per cent?

MR. THOMPSON: We would not like to make such a request on behalf of the manufacturers.

MR. COLLINGE: I do not believe this committee thinks they are mature enough, but I would not like to say it officially.

MR. ROTHWELL: I do not think we suggest the 6 per cent bank rate ceiling should not be removed. I think the expression is that some people would be quite willing to pay more than 6 per cent if they were assured of the banks' support they needed when they wanted it. They are not so sure that raising the ceiling from 6 per cent to 7 per cent, for example, will, of necessity, solve the availability problem. Because of a lack of certain belief in this group, you will find this thing is absent from the brief, deliberately absent. We have not commented on the 6 per cent because we, ourselves, find it hard to agree with any kind of a uniform view. So, we do not say it should be raised.

COMMISSIONER LEMAN: You mention factoring. As I understand it, generally these days factoring

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COMMISSIONER LEMAN: You mention factoring. As I understand it, generally these days factoring

represents an interest cost to the borrower of about 13 or 14 per cent, so if the banks were financing working capital in small firms at 8 per cent, say, it would still be a lot better than most factors can make available.

MR. THOMPSON: I have seen instances of that, where the effective rate after penalties have been applied, was running over 20 per cent. If the individual was going to stay in business, that is the only source that he had from which to obtain funds, and his overall decision was that he had just about as much current debt as current assets. It was not an attractive proposition for the banks though the banks could, against Section 88 and against assignment of the accounts. But in this individual situation you could not even get a nickel from the bank, and the only way to stay alive was to get into the hands of these factors. It is just cruel, the rate these people are able to extort under these circumstances.

COMMISSIONER MACKINTOSH: The reason why government does not, in normal times, impose a ceiling on the prices at which manufacturers sell is not because there is a touching trust in manufacturers. There is an assumption that externally or internally there will be enough competition to arrive at a reasonable price. Do you fear that if the ceiling was not raised but removed on bank interest rates, so there would be no suggestion of an administered price -- do you fear there would not be enough competition to maintain rates on the average?

represents an interest cost to the borrower of about 1½ or 1¼ per cent, so if the banks were financing working capital in small firms at 8 per cent, say, it would still be a lot better than most factors can make- [illegible]

MR. THOMPSON: I have seen instances of that, where the effective rate after penalties have been applied, was running over 20 per cent. If the individual was going to stay in business, that is the only source that he had from which to obtain funds, and his overall position was that he had just about as much current debt as current assets. It was not an attractive proposition for the banks though the banks could, against Section 88 and against assignment of the accounts. But in this individual situation you could not even get a nickel from the bank, and the only way to stay alive was to get into the hands of these factors. It is just cruel, the rate these people are able to extort under these circumstances.

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MR. THOMPSON: Are not you inviting rather a comparison of our banks and the degree of competition of our banking system, as compared to that of the manufacturing industry?

COMMISSIONER MACKINTOSH: Why not?

COMMISSIONER LEMAN: You gentlemen seem to be a little hesitant on this question.

THE CHAIRMAN: They said that the membership was not in such a state of agreement that they are prepared to take any position on behalf of the membership.

COMMISSIONER BROWN: I have the impression that those to whom bank money is available would like to see the 6 per cent ceiling; but those who have to go to the factoring end of it would like to see it removed.

MR. ROTHWELL: Or raised.

MR. WILLS: I think we are concerned with the fact that raising of the interest rate is not going to make more funds available and is going to cause higher rates than when raising money today.

THE CHAIRMAN: Is not the problem the availability of money?

MR. WILLS: Yes.

COMMISSIONER MACKINTOSH: There is no suggestion here of raising the interest rate. The only suggestion in question is that of removing a limit which, when the interest rate is raised, squeezes the top sector of demand off from availability. They cannot lend above 6 per cent. Therefore, they prefer

not to lend. It is not a matter of saying interest rates in the future shall be higher than they have been in the past. If that was the question, presumably it was rejected.

MR. FLYNN: Doesn't it boil down, basically, to the degree of risk -- the degree of risk and the higher rate of interest required for greater risk?

MR. THOMPSON: It also applies a variety of rates and you could shop for rates.

MR. DOBBIE: Quite purposely we did not make any recommendation on it, as you can see.

COMMISSIONER LEMAN: But you are here because we can question you on your deliberations? As a matter of fact, I have a feeling that Dr. Mackintosh did not get an answer to one of his questions. Perhaps you would like to put it again, Dr. Mackintosh? I think it should be answered.

COMMISSIONER MACKINTOSH: I am not sure which question it was.

COMMISSIONER LEMAN: That is the question, is there sufficient competition in the banking system to make the system work?

MR. DOBBIE: We asked ourselves that question, and we came to the conclusion that in the field there was competition between the banks.

THE CHAIRMAN: Can not you go beyond that? There are other institutions today which have grown to a great extent, which have been competing with the banks in certain fields.

MR. DOBBIE: Yes.

COMMISSIONER MACKINTOSH: May I ask Mr. Dobbie if he means that he thought that he detected a trace of competition?

MR. ROTHWELL: My impression is there is a great deal of competition between banks. I am not so sure it is not a well regulated and controlled competition, but it does exist today. Whether it would exist under other circumstances, I do not know.

MR.DOBBIE: We feel also there are areas where there is more competition than in others. In our own discussions we thought you might go from bank to bank, in certain circumstances, and get various terms, and we thought there are other areas that are pretty well standard.

COMMISSIONER MACKINTOSH: Would you go this far: if it was thought desirable to recommend removal of the ceiling you would welcome also other recommendations which would contribute to an increase in bank competition?

MR. DOBBIE: I think we can go along with that statement.

MR. COLLINGE: As a committee we have to be very careful.

COMMISSIONER BROWN: Let us poll you individually!

MR. COLLINGE: We are trying to represent the Association.

MR. WATSON: It seems to me there are other fields that have operational advantages than interest rates. But there are many angles of service concerned which I think one bank has over another, as to a certain

rate, and so on, which are apparent in shopping around, as most people do. There are a lot of other things to look at besides merely the bank rates. So I think the answer as to whether there is competition among the banks is, yes, definitely. I have stressed on various occasions, chiefly as to service, and other items I need not bore you with because you know all about it -- co-operation, terms and various extra services beyond the call of duty, and things like that. In that the banks are in definite competition.

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COMMISSIONER MACKINTOSH: I would not like this to be represented entirely as a virtue of the banks. I was thinking in terms of the development of the money market, the expansion of various near banks. The banks are more competitive now than they were, say, a generation ago - to put it back far enough not to be contentious - they are in a more competitive situation, whatever desire the individual banks may have.

MR. COLLINGE: Would it be in order to say that we, as representing the Association, feel definitely that there should be a source of capital which might be at an interest rate greater than the 6 per cent, and which could therefore take a greater credit risk, but which is not as costly as the factor.

MR. DOBBIE: This is what we are in essence saying in paragraph 61.

MR. COLLINGE: Whether the banks as a medium do this, we on behalf of the Association cannot say, but we can say the other.

COMMISSIONER LEMAN: That is all on this score, Mr. Chairman.

COMMISSIONER BROWN: Could I ask this one question before it is forgotten? Mr. Potter earlier referred to the question of bank mortgages and made the statement, if I noted it correctly, that this would be an alternative to asking for more government money for the purpose. What was the intention of that?

MR. POTTER: We were asked how the complaints of small businesses in the questionnaire reflected in

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MR. POTTER: We were asked how the complaints of small businesses in the questionnaire reflected in

these tables, were reflected in our brief. Small businesses in many cases represented that they would like to see more money available from the Industrial Development Bank. They would like to see mortgages or similar facilities available from the chartered banks, in some cases. The feeling was that one way to meet this need was to have the power to make money available on industrial mortgages - that is, the chartered banks. That is, as stated in the preamble to this brief, and I believe elsewhere.

The Association approves of the Industrial Development Bank, but would rather see an expansion of private enterprise funds rather than government money.

COMMISSIONER BROWN: Your reference to government money was a reference to I.D.B. money?

MR. COLLINGE: Yes, to I.D.B. money.

THE CHAIRMAN: We will adjourn for ten minutes.

--- Recess.

COMMISSIONER MACKINTOSH: I would like to direct attention to an earlier section of your brief in which you set out what you consider to be the objective monetary and fiscal policies, and modestly refrain from making any suggestion to the Commission as to what we should recommend with regard to them. There is one striking sentence in paragraph

"The Association regards wage increases not directly related to an equitable sharing of increased productivity as having

"been in practice a more important source of price inflation in Canada than unjustified expansion of the money supply." We have had some other expressions of opinion from persons whose experience has been in other countries, with emphasis on this. In most cases they are related to industry-wide collective bargaining having been established. This raises the very important question, whether you really think there should be some policy proposals that would deal with this?

You have formulated in fairly general terms and incomes-profit set-up as a guiding light, and one or two other devices. Are you just registering a passing complaint, or do you want to do something about it?

MR. DOBBIE: I will ask Mr. Watson to give you our thinking on this particular section.

MR. WATSON: I think it is fair to say that what you might consider the wage-cost push inflation has been and will continue to be a matter of very serious and vital concern to manufacturers.

There are a couple of reasons which I think were not specifically dealt with in the submission, or were not made the subject of specific recommendation. One is that, rightly or wrongly, we felt that our monetary banking policies, financing policies, which are under consideration by the Commission, do have an indirect influence on all sectors of our economy to some degree; but they did not seem, in our view, to have a direct impact on wage rates. That was one part.

The other thought was that any possible legislative action to be recommended, bearing directly on the matter of wage rates, would probably fall more into the provincial than the federal jurisdiction. But the matter has been under considerable study by the Association, and while we are not in a position at the moment to make definite recommendations, it is certainly a matter of serious concern.

Our thinking on it is this - if you will excuse me quoting from rather cryptic notes I have here: Wages, of course, are a large component of manufacturing costs. With continuing post-war rise in wages up until the late fifties, mostly passed on to consumers in some higher prices, might be called a cost-push type of inflation. As the transition from a sellers to a buyers market progressed, this passing on became increasingly difficult.

This setup followed a chain of consequences which is still in operation. Manufacturers were more and more forced by competition to absorb increases in wage costs: thus, a further squeeze on profits; thus an intensive search for compensating cost reductions; thus increased requirements for automation; thus rising unemployment. In other words, rising wages seem to have collided with the law of diminishing returns.

That, I think, is as far as our thinking goes at the moment on it. That boils it down. Whether at some future date we would be prepared to make some specific recommendations, is something else. This was noted in the letter that came to us a fortnight or so

ago, but there was not really time to canvass our members at large to get their views and opinions on the matter. Frankly, we were not yet settled in our minds, although it is under continual study just what we would recommend.

So I think, Mr. Dobbie, that is about as far as we would be prepared to go. This is certainly a matter for discussion.

I might cite a few figures. These happen to be taken from the records of my own company, and bear out that chain of consequences I mentioned. Would those be of interest to the Commission?

COMMISSIONER MACKINTOSH: I think so.

MR. WATSON: I compare the year 1950 to the year 1961 and I quote on a percentage basis the change in these various factors in that 11-year period. I interject that during this period, on account of this process I have outlined, we did go extensively into automation, installed a great deal of automatic machinery - forced to by rising costs. Fortunately, in the first part of that period we had sufficient retained earnings; latterly, the retained earnings have not been so good.

I go on now with the comparison. The volume of business between 1950 and 1961 increased 24 per cent. The numbers on the payroll - these are all below executive level - decreased 43 per cent. The payroll in dollars increased 27 per cent, and the average wages of employees increased 123 per cent. In other words, the wages more than doubled, but I would point out that that is possibly higher than the average. It so happens that with the installation of

a great deal of automatic machinery the calibre and skills of our employees have advanced considerably. I cite those figures because they back up this chain of consequences.

So, we are very vitally concerned with the cost push. Up to this point we were able to pass on that cost push, but since that time - speaking of manufacturers as a whole - we were not.

On the national basis the Association is, of course, very much concerned with unemployment and is seeking to find causes of it. In doing so we stumbled on one, which is not an earth-shaking discovery, because I think a lot of other people made the same discovery. However, it certainly was confirmed by a study in the matter, and looking at it in our own business. Perhaps I have given an oblique answer to the question, sir.

COMMISSIONER MACKINTOSH: I think that is useful. However, I think on the evidence that you stated in the earlier part of that period, up to the watershed, whether that is 1956 or 1957, was not a cost push; it was simply labour taking advantage of demand pull, when the manufacturers in a good year found that the easiest way out of wage negotiations was to give a wage increase.

MR. WATSON: I think that is the truth.

COMMISSIONER MACKINTOSH: I do not think you can classify that as a cost push. A great many situations which appear to the individual manufacturer as a cost push, really represent a demand pull from some

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MR. WATSON: I think that is the truth.

COMMISSIONER MACKINNON: I do not think you can classify that as a cost push. I agree there are situations which appear to the individual manufacturer

other industry which uses a similar kind of labour. They are appearing to raise wages and they do raise wages, and then the demand for increased wages spreads to other industries. But there is a question which always appears to an economist: one of the ways an employer can protect himself, an industry can protect itself, against a successful wage demand, is to divest himself of some of his purchasing power by reducing price first. Very little of the earnings of industry in the period when earnings were very buoyant have gone into price reduction, which has the advantage of spreading the result of productivity right across the population, instead of making it a bone of contention between management and labour within the industry, and where the most buoyant industry sets a wage rate which the others in some fashion have to meet.

The whole concept of passing on the results of productivity in some measure to the consumer has become a very old-fashioned consideration. It seems to me that many industries in periods of buoyant business leave themselves very exposed. Frequently they pass through times when they have the resources, or timeswhen they don't need to make price concessions for competitive reasons, Later when competition gets keen, they are left both with competition and the enhanced wage level.

Would it be your view generally that this question of cost or wage push simply has to be left to competition and it is a spread of information and knowledge?

MR. DOBBIE: May I answer one question before that and we will come back to your second question.

COMMISSIONER MACKINTOSH: Glad you mentioned it.

MR. DOBBIE: You brought up one point, that with regard to the cost of production. I would like to ask Mr. Keaveney to make a comment on it, and then we will come back to your main question.

MR. KEAVENEY: Dr. Mackintosh, did I understand you to say that manufacturers had not reduced prices?

COMMISSIONER MACKINTOSH: I am speaking generally of this earlier period when things were buoyant. I do not for a moment suggest that they are not trying their best to get into the price competition situation.

MR. KEAVENEY: I think in certain industries there have been very drastic price reductions. I speak particularly of the electrical apparatus industry where if one takes the price of large power transformers, he will see that today they are selling at less than 75 per cent of the price charged in 1950. Now, certainly to some extent this is the result of cost reduction through design improvement and so forth, but I would say to a much more marked extent it is due to excess capacity in this country, where there is most severe competition.

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it is true of others, despite the fact that in that time wages have gone up very significantly. So, the manufacturers have been faced with a wage cost push, which has not only not been offset by a price increase but has been accompanied by price decrease.

COMMISSIONER MACKINTOSH: Do you attribute this cost push to industry-wide bargaining?

MR. COLLINGE: In one industry the most profitable parts do not fight hard to keep the wage level at what would be satisfactory. This is a fact.

MR. THOMPSON: I don't think you can overlook the significant effect of the wage pattern in the United States and how it is reflected in our Canadian wage rates. If you go back to the post-war period when we had great development of our raw material resources, those industries set a very high level of wages, and through a shortage of labour manufacturing industries were in competition. Even in the most profitable areas, and where some industries were not profitable, they had to meet these competitive conditions.

There are two factors; there is this shortage of labour in the post-war period and with the willingness of , I think, a lot of our primary producers whose wage costs haven't been as significant as in manufacturing, to meet higher wages. The effect of the United States wage increases all had a bearing and there was pressure on the manufacturers to do everything to meet these wage increases. I don't think it was a matter of the manufacturers sitting on their hands; I think they were conscious of their problems but they were caught up in a situation which I think is beyond their control.

MR. COLLINGE: I think we might add that there was one place where this tax policy and related policies did affect wage earners. It is very difficult for a manufacturing enterprise to deal with a unit that can demonstrate that its costs of living have increased as the result,say, of an increase in a tax level.

COMMISSIONER MACKINTOSH: You have been able to restrict wage increases with that measurement, but wouldn't they have been much less than historically they have been? Labour has done a great deal more.

MR. KEAVENEY: I would think that is particularly so over the last two or three years where our rate of productivity nationally has been extremely small, and this really gets back to the point we have mentioned in our brief in relating the wage increases to an equitable sharing of the fruits of productivity, and I think it is not correct

to say and I don't subscribe to the theory that providing wage increases are equal to the gains in productivity, that that is a satisfactory theory in North America today, and in as much as first of all so much of the fruits of productivity nowadays are the result of the installation of capital equipment and management to a very large extent, and that really one nowadays in Canada has to look to some part of this productivity to assist our competitive situation world-wide. So, you can use part of this productivity to reduce costs.

COMMISSIONER MACKINTOSH: Well, I am not sure how you apply productivity or how you define it, actually; surely it will not be applied in any other way than if for the same cost or output it is being decreased by two and one-eighths per cent or three per cent, or whatever you use, that that would be applied to the wage sector of your expenses, which would leave an equal percentage to be applied to the other sectors of your expenses, contribution to capital and management, and so on?

MR. WILLS: The important thing in productivity is that your lessening of cost should be shared by all segments of the economy rather than to be shared wholly by labour.

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COMMISSIONER MACKINTOSH: I think that those are all the questions I have, Mr. Chairman.

COMMISSIONER GIBSON: I would like to carry on and ask a few general questions; questions about your views as to national financial policy.

THE CHAIRMAN: Before you do that I just have one question which I wanted to ask following up the figures, Mr. Watson, that you gave. You gave us a 24 per cent increase in volume of business and a total payroll increase in dollars of 27 per cent. You didn't give us a figure for the cost of increases in capital. There must have been a change in increases in capital.

MR. WATSON: It would be very substantial in proportion to the turnover of business. A great deal of our return during that period, the early part or the latter part, would be devoted to replacement of people by machines. We have excellent employee relations and a fine staff and we have no union. But it is very difficult to dig out these things, the actual capital expenditures, because some are replacements and some are actual purchases of labour

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saving machinery and some are merely modernization. I can tell you that they were very substantial for a small firm like ours.

COMMISSIONER GIBSON: I might ask a couple of additional questions about your views about the objectives of policy, financial policy. You say in your introductory statement, paragraph 5, that the Association would like to affirm what it believes should be the goals kept in view by the authorities; economic growth, economic stability, the avoidance of price inflation, a suitable foreign exchange rate and the minimization of unemployment, both of manpower and productive capacity. Then you go on to say that the government should be especially vigilant in restraining their spending at times of restricted credit conditions so as not to compete unnecessarily with private businesses.

Now, these are all excellent objectives. Would you say a word or two about how you regard them and which are the most important objectives from your point of view? We have heard a lot about what the objectives of monetary policy ought to be and some people put priorities on one objective and someone else on another. Would you say something about that?

MR. DOBBIE: We haven't applied any rating to that, sir.

COMMISSIONER GIBSON: You don't believe they are in conflict? Is there any possibility that the

objective of price stability and avoidance of inflation is in conflict with the objective of minimizing unemployment or with a stable exchange rate? You are not prepared to talk about these things?

MR. DOBBIE: It is like sin, everybody is against it and this covers how we look on these things.

COMMISSIONER GIBSON: So do we.

MR. DOBBIE: We haven't any priority on that; we feel that these are objectives that we should always have in front of us and work towards them; like many things in the economy, one may pull and the other may push, but you have to give up something for something else, but in the total objective we feel that this is what we should be shooting for.

COMMISSIONER GIBSON: Yes, but as a practical matter there are times when there is conflict, and this is the sort of problem we have to look at.

MR. DOBBIE: I could think of times -- for instance, along that line, nine months ago where our foreign exchange rate was working to the detriment of some of these other things; is this the type of area that you wanted to delve into?

COMMISSIONER GIBSON: If you can talk about it. I don't want to ask you qeustions that you are not prepared to talk about or do not have views on.

MR. WATSON: I might well be that that is a part answer to that question. I can understand

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that you are moving for virtue as against sin.

COMMISSIONER GIBSON: We all are.

MR. WATSON: And the thought, therefore, is that this is one of the objectives, but I think that we covered this earlier on in part of the brief; that we are far from being monetary experts and therefore our ability to suggest a mechanical means -- monetary-wise or otherwise -- I am afraid we would be getting out of our depth.

COMMISSIONER GIBSON: We are not asking you about monetary techniques. We are asking why you regard some objectives as being more important than others.

MR. ROTHWELL: I think this has not been discussed by this group as a group and, therefore, if a question such as that is answered that answer must be the opinion only of the individual who made it. I think for years past we have had in Canada something along the line of a controlled inflation. We have had, certainly up to very recent years, an economic growth. I think that from the way things are most of us are convinced that to have economic growth, to have maximum employment, we must have along with those things some kind of a dose of price inflation. As you say, these things are in conflict, but I am quite sure that all of us expect some kind of a dose of price inflation, and so on, if we are to have economic growth and reasonably full employment.

So, the answer is that economic growth is more important than price inflation, but a lot depends upon how much price inflation there is. I think there can be a measure of stability if those things are kept under reasonable control. I am quite sure that no matter what we do we are going to have a price inflation of some variety in the years ahead.

There is the exchange rate, for example. We have now a discount down. It is favourable to many segments of our economy, both to the primary producer and the secondary producer, but undoubtedly

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this is going to have an impact, and is having an impact on prices in Canada, particularly, of course, on the price of imported commodities. There is also the fact that if we replace an imported commodity with a commodity made in Canada -- an imported commodity that can be replaced because it is priced out of the market -- then the commodity that is produced in Canada is going to be higher in cost in all probability than the commodity it replaces and which used to come in at a lower figure but which now comes in at a very much higher figure. But, to have economic growth we must be prepared to put up with a degree of price inflation.

COMMISSIONER GIBSON: This is a very interesting view. You are saying, in effect, that to attain a reasonable degree of economic growth you are likely to have some price inflation, or some price increase?

MR. ROTHWELL: That is my personal view.

COMMISSIONER GIBSON: I did not express that view. I said that sometimes these may be in conflict -- sometimes they are in conflict immediately; sometimes they may be in harmony when you take the longer view. But, it would be fair, according to your view, to say that we would have to put up with some price increase?

MR. ROTHWELL: History has taught me that. The first job I ever held was for $10 a week. That was a regular job and that was the regular rate of pay for that job. How many people can we find

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to work for $10 a week now? That is inflation. So, I have lived through an era of steady inflation, and I am convinced that it is going to continue happily. Perhaps we can keep it at a modest rate and still have these other things.

COMMISSIONER GIBSON: Are you concerned about that view? What if everybody held the view and tried to protect themselves against inflation?

MR. WILLS: There is a view that inflation over the last several years has resulted in lower profitability to the producer, so that the fact that the price has not gone up does not necessarily preclude inflation.

COMMISSIONER GIBSON: You mean you have had a deflation of profits?

MR. WILLS: That is right. If the price had been maintained your profits would have been higher.

COMMISSIONER BROWN: What do you mean by reasonable inflation?

MR. COLLINGE: There are some of us who believe that all the objectives can be achieved by providing suitable skills. This is not necessarily an Association view.

COMMISSIONER GIBSON: No, no.

MR. DOBBIE: These are individual views, sir.

COMMISSIONER GIBSON: What do you think is a reasonable average increase in price? Do you think an increase of 3 per cent or 5 per cent consistently

is reasonable?

MR. CRABTREE: I could not answer that. I would think that is high. 3 per cent per annum is a pretty fair dose of inflation. I would think that our objective should be to have it much lower than that.

MR. DOBBIE: That is true, but are we getting inflation mixed up with cost increase?

COMMISSIONER GIBSON: They are closely related.

MR. DOBBIE: Very, but where is the dividing line? For instance, I may be in an industry which is importing a certain amount of raw material from the United States. Obviously the cost of the raw material has gone up in the last six months. Balanced against that we would hope to get more of the Canadian market, but because we are competing with American-finished products coming into this country we have an increase in a percentage of our total cost. If we expect to get more of the Canadian market our unit cost should go down with longer production runs, and we will be able to balance that against the increased cost of our raw material.

COMMISSIONER GIBSON: Yes. I think if you are talking about inflation you have to use fairly broad measures. There is a movement of the whole price level, and the strain on one industry as against the strain on another will vary at any particular time.

MR. COLLINGE: Can I express a personal

view? It would seem that we believe the primary objective at this time is economic growth. Having regard to the demands of the welfare state unless we can grow economically we shall collapse utterly. This would be my view. Secondary objectives like economic stability have to do with the level of the whole population. They are obviously desirable, but the prime one is economic growth.

MR. FLYNN: I think economic growth has a great deal to do with our tax structure in this country. Possibly we are anticipating the next royal commission and getting into that, but we have mentioned this in the brief and I think a thorough review of the tax structure and a getting away from some of the sectional interests in that area can contribute and should contribute to economic growth.

THE CHAIRMAN: This is just a preliminary skirmish here.

MR. FLYNN: Most of us here are mature enough to have gone through a period of economic decrease and deflation. None of us enjoyed it. It was very unpleasant for most of us.

COMMISSIONER GIBSON: This leads to another question. You put a lot of emphasis on the importance of growth. Some of you seem to be willing to put up with some price increase if that is necessarily involved, but when you come to discussing the question of fiscal policy and what the government ought to do from the expenditure point of view you make this statement in paragraph 23:

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"There is a legitimate place for budget deficits and for the growth of the public debt, within the limits imposed by the growth of the economy and the ability to carry debt. But fiscal policy must harmonize with the sound management of the nation's affairs and must not lead to dangerous monetary expansion and inflation."

Again, these are not exceptional views, but what does this mean in a period where you have got quite a lot of unemployment and an inadequate -- or an absence of -- rate of growth? Look at the last few years; how do you feel about budget deficits in those circumstances?

MR. COLLINGE: The answer might lead you to believe that we are talking to a Liberal caucus.

MR. FLYNN: I do not know the answer to that one. We have had $3,000 million of deficits in the last five years, and in the last nine years I think there has been a deficit of $9,000 million in our international balance of payments, and during that time the Gross National Product has not been growing as it should have been to carry that. There must be a relationship there somewhere, but I do not know what it is. I am not an economist. It seems to me that we have been living off our own fat too much. What specifically we should do at this stage is a problem.

COMMISSIONER GIBSON: You are not against the government's endeavouring to facilitate recovery

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MR. COLEMAN: The answer might lead you to believe that we are heading to a financial crisis.

MR. HUNT: I do not know the answer to that one. We have had $3,000 million of deficits in the last five years, and in the last nine years I think there has been a deficit of $2,000 million in our international balance of payments, and during that time the Gross National Product has not been growing as it should have been to carry that. There must be a relationship there somewhere, but I do not know what it is. I am not an economist. It seems to me that we have been living off our own fat too much. What specifically we should do at this stage is a problem.

COMMISSIONER GIBSON: You are not against

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because you advocate tax relief of a kind which you believe would permit expansion in industry. That would cost money, and it would cause deficits in times when things are not good.

MR. FLYNN: This is purely a personal view. What concerns me is that the horse is out of the stable and we are now talking about closing the door. In other words, we had all these deficits in a period when we need not have had them. We need not, I think, have been accumulating deficits during the last few years because, while there was not the growth in the Gross National Product that we expected, we still went through some fairly good periods. Now it has caught up with us, and some economists think that business is going to slope off and we are really faced with a problem. I cannot answer that. I do not know whether we should have more deficits now, or whether there should be real retrenchment, as Mr. Collinge has said.

COMMISSIONER BROWN: Mr. Flynn, you would not suggest that income taxes were too low in the last few years? You are suggesting we should not have had deficits?

MR. FLYNN: We should not have spent so much.

COMMISSIONER BROWN: You are not suggesting that taxes were too low?

MR. FLYNN: I am suggesting that our expenditures were too great.

MR. DOBBIE: I do think -- and this is

again a personal viewpoint -- that over-shadowing this whole subject is the great number of young people who are coming on to the labour market in the next few years. I think it is taken for granted that most of them have to be absorbed by the manufacturing industry if they are to have gainful employment.

COMMISSIONER GIBSON: Manufacturing and services.

MR. DOBBIE: Yes. I think we should begin looking for the answers as to just how industry is going to absorb these people. Getting back to your first question, I personally would put economic growth first in this list in paragraph 5 because I hate to think of the consequences from the social aspect, from the political aspect, or from any aspect from which you wish to look at it, if these people are not employed.

COMMISSIONER GIBSON: What are the most important policies we should pursue in regard to this? I do not want to tie you down as to the techniques, but are they tax reduction policies; are they government expenditure policies; are they monetary policies; or are they selective efforts to stimulate industry in certain directions? What directions are you thinking of?

MR. DOBBIE: In our opinion, sir, the recommendations are made in Nos. 4, 5 and 8. I am speaking from memory now ---

COMMISSIONER GIBSON: Your emphasis is on taxation.

MR. DOBBIE: Yes, Recommendation No. 4, Recommendation 5 and to a certain extent Recommendation No. 8, but Recommendations 4 and 5 go to the heart of it. This is something that we can see concretely that would help manufacturing.

COMMISSIONER GIBSON: In looking at this complicated Canadian economy, and thinking in terms of appropriate economic policies, may I say that we heard the other day from a Swedish economist, Dr. Lundberg. We heard of how they do things in Sweden. They do quite a lot in this direction there. They have a national wage policy, or a wage policy which is being hammered out between industry and the labour unions so that it has become almost a national policy. But, with all of the direct measures that they use he says that one of the basic principles is to keep an open door to foreign competition. He said that that is a very important factor in the high rate of growth of the Swedish economy during the last four or five years.

THE CHAIRMAN: They do not believe in protection.

COMMISSIONER MACKINTOSH: I think you should add to that also that these measures are accepted fully by Swedish labour.

MR. DOBBIE: But relative to what? How much do they spend per capita on imports at the present time compared to what Canada spends?

COMMISSIONER GIBSON: I do not know, but they spend a lot. It is a high import country.

COMMISSIONER BROWN: They export the same percentage of Gross National Product as we do.

MR. WILLS: Have they had an adverse balance of trade over the years?

COMMISSIONER GIBSON: They manage their affairs so that they do not. They are not great importers of capital.

MR. FLYNN: I wonder if they have as high a per capita importation of consumer goods as this country has.

COMMISSIONER GIBSON: I do not know. What do you think of this policy?

MR. COLLINGE: It has worked well in Sweden.

THE CHAIRMAN: They also have an inflation of 4 per cent a year, and the wage rates increase by 7 per cent per year.

MR. COLLINGE: I think Commissioner Gibson asked his question the wrong way round. The real question is: Is the Canadian genius adequate to cope with this problem?

COMMISSIONER GIBSON: That is making it pretty broad. No, I was thinking specifically of what do you think a fairly open approach is from the standpoint of a Canadian manufacturer.

MR. THOMPSON: There is the fact that we have such large amounts of imported goods coming into Canada. Is not that indicative of the fact that we do have an open door policy towards imports?

COMMISSIONER GIBSON: No, it is indicative of

the fact that we import a great deal.

MR. THOMPSON: Those goods would not be coming in unless there was a market.

MR. COLLINGE: Could I comment that in the years of expansion after 1946 Canada decided to put her available capital into things that she knew, such as agriculture and pulp and paper. We are in a position today where we have more than enough of all these facilities. If cheap money or any other device merely makes us expand those facilities further then we are in deeper water. The problem is to get it channelled into new things that we need, and no aspect of fiscal policy will do that.

COMMISSIONER GIBSON: But what I am getting at is this, sir, this is an objective we all agree with. What is the best kind of broad approach to reach this kind of objective? We are talking about our fiscal policies and our monetary policies, and the relation of these things one to the other. Which are the important things, and where do we put the emphasis?

MR. ROTHWELL: Have not they been solved, in part, by the combination you referred to in Sweden, the inflation of 4 per cent per annum and the open-door policy, and so on? Obviously, they must have a combination by which the inflation in prices of these keeps the secondary manufacturing going to some degree in Sweden in the face of an open-door policy. I think you would have to take that whole thing and work out the circumstances of the combination that makes this thing tick.

COMMISSIONER GIBSON: I am not asking you to comment on the Swedish position.

THE CHAIRMAN: There are also other factors which make it different.

MR. ROTHWELL: I think it is unquestionably desirable that we manufacture as much as possible in Canada and that we encourage this domestic operation and create jobs, and so on. If the open-door policy results in this diminishing then, of course, we are creating domestic problems. Some industries in Canada would stand up very well to an open-door competition and some, I think, would

go under in an awful hurry. Sweden, perhaps, is not blessed or cursed by the large neighbour we have and the large manufacturing capacity that lies across our border. Is that so?

COMMISSIONER GIBSON: It is pretty close to Germany and Britain.

MR. ROTHWELL: Transportation costs in Canada are a very big factor in our economy. You gentlemen will know that more than I do. I do not know how to answer your question myself.

COMMISSIONER GIBSON: Let us go on to the foreign exchange policy.

THE CHAIRMAN: Before you leave that, it seems to me that sometimes we focus our attention on techniques of monetary policy and the money supply, and policies of that kind, and forget the very obvious thing, and that is that at the present time we are undergoing a state where there has been a weakness in demand -- that is, real demand. You have mentioned that in your brief.

Comparing Sweden again, we are told that in Sweden the demand has been very strong throughout those years, which gives the whole economy a backbone. But if demand weakens it may be that some of these techniques and policies, if applied, may have much less effect than you might expect. The big problem is one that involves, perhaps, a change of structure in our economy which will have to be met by industry in some way, to provide means of falling in with the structural changes that

are going on. They are very basic, it seems to me, and not entirely monetary. Some means of stimulating demand -- and that is in the real world and not in the world of theory -- that is the problem.

MR. COLLINGE: The problem is to make a new thing that we can sell.

THE CHAIRMAN: In connection with that, if you can devise some new products for which you can stimulate a real and big demand, that increases productivity and growth.

COMMISSIONER GIBSON: Could I ask a few questions about foreign exchange policy, Mr. Chairman?

THE CHAIRMAN: Yes, do.

COMMISSIONER GIBSON: You have a table in your survey on foreign exchange rates, and asked a number of questions of the respondents as to their attitude to the recent change in exchange policy, or the change that occurred up to May 2nd, and then when the fixed rate was announced you separated it. This shows quite a few of your respondents are really interested and have some positive ideas about what they are going to do with the lower rate of exchange. I do not know whether I am interpreting this correctly, but some of the replies are a small proportion of the total. On the other hand, you are asking them fairly positive things -- whether it will increase their export sales, whether they will be able to improve their competitive position in Canada. How do you regard this survey? Are you encouraged by what you find here?

MR. KEAVENEY: As you are aware, this survey was conducted at a fairly critical time, and the answers we received were during a period just shortly after the dollar was pegged in May. Accordingly, one does have to take that into account in assessing the answers, because it could well have been too early after the devaluation took place for any kind of a definite pattern to show up.

However, if I could refer to some of the questions, it may help to answer these points you have raised. I think that, first of all, in considering the number of replies in the affirmative to any of the questions, the important thing is not that the number of replies might have been small in number but what they might have meant in terms of employment for the companies involved. For instance, in one of the questions, No. 3, we asked: "Are you now making or contemplating making new products in Canada which because of competition would not have been possible before the depreciation of the Canadian dollar?" Of some 500 replies only some 17 per cent, 85, said "Yes".

First of all, it might have been too early after the change in rate for people to have made up their minds to go ahead with any new production to replace products previously imported. But speaking for my company, John Inglis, we have over the last year taken over the manufacturing of a product previously imported where there is a very significant dollar value involved, generating a fair amount of

employment. I do feel this change in the dollar rate can lead to some stimulation of additional employment in Canada.

COMMISSIONER GIBSON: If 17 per cent replied they are going to do something as far back as May, that is a sizeable number. Of course, you do not know what they are going to do, but a new product is a specific thing.

MR. KEAVENEY: My point is it could well be considerably more than that.

MR. WILLS: The chances are that 100 per cent would not have an exportable product anyway, so 17 per cent is quite high.

MR. ROTHWELL: I think the impact of the change in the rate has been developing subsequent to this survey. I am constantly hearing now of products being made in Canada which were not made here six or eight months ago, and which are made possible by the present exchange rate.

COMMISSIONER GIBSON: You view this as a major push in Canadian manufacturing, this change of rate?

MR. ROTHWELL: Yes.

MR. KEAVENEY: I would say it will be a significant factor and, of course, the position has been emphasized by the introduction of the duty surcharges in June, which is a move in the same general direction. Nevertheless, despite this, Canadian manufacturers are still faced with pretty

serious problems when it comes to competing with imported products from the United States, where their production runs so very much larger than ours. In several cases I would expect these things in themselves would not rectify the whole position, but I do believe they will make a sizeable contribution.

COMMISSIONER GIBSON: This is, after all, a difference of 10 or 12 per cent, compared with one and a half or two years ago?

MR. KEAVENEY: Yes, and it has a very sizeable cumulative effect when you take into account the effect of the rate on duty and sales taxes, and so on.

COMMISSIONER GIBSON: I am wondering about the comments on a flexible versus a fixed rate.

MR. KEAVENEY: Yes.

COMMISSIONER GIBSON: Do you take these replies seriously? I wondered, in looking at them, if some people were really saying they were in favour of a lower rate rather than a fixed rate, because the lower rate is associated with the fixed rate.

MR. KEAVENEY: I think that there the figures to look at are the comparison of "yes's" and "no's". There is a large body with no strong opinion. I think, in considering the pegged rate, one does have to take into account the position of a manufacturer who might have in mind an expansion programme of some kind. Over the last several years there have been some pretty marked fluctuations in exchange rate. In considering whether or not he would go into the

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production of a particular product which has been imported in the past, as far as duty rates have been concerned he has been aware what they were and that they were not liable to change very much. But several of us certainly feel a fluctuating rate does create quite a considerable air of uncertainty which is not conducive to proceeding with plans for expansion in Canada. I also think that this relates right into the area of cost where with the pegged rate at least you are able to establish your costs accurately; and, similarly, as far as receipts from sales in the case of exports are concerned, you do know what your receipts are going to be.

COMMISSIONER GIBSON: This is true. But, after all, we have had a period since 1950 of a free rate, and I do not remember such a lot of complaints about it, except in the last few years, when the free rate was a pretty high one and people were particularly complaining about how high it was. Do you think it is really the objection to fluctuation rather than the height that people are complaining about?

MR. KEAVENEY: I think it would be difficult to say yes specifically to that, Mr. Gibson.

I think -- going back to the first point you made -- you wondered whether or not the answer was influenced to some considerable extent because it was a discount. I do think it could well be possible that people answering this in the affirmative were considering the benefits they themselves might

gain because they were now in a better position to compete.

MR. COLLINGE: There is another side to the exchange rate which might not be widely recognized. In some areas of Canada's business, where there is over-production right throughout the world, the exchange rate decrease has not had the effect of causing the credit to be depreciated or the American dollar, but it has had the net effect of causing price decreases. So, at least for some sections of the economy, it has no benefit and it is not a protective device.

COMMISSIONER GIBSON: These price decreases would not have occurred if the exchange rate had not been reduced?

MR. COLLINGE: There is a suspicion that Canada, in some fields, can dominate the world price.

COMMISSIONER GIBSON: I can think of several examples, but they are major world commodities, and it is possible they would have gone down anyhow.

MR. COLLINGE: It is conceivable, but perhaps not so much and not so vigorously.

MR. KEAVENEY: Certainly so far as domestic selling prices are concerned, I cannot see any trend generally other than an upward adjustment of prices, because quite a substantial proportion of our total cost of manufacturing is represented by imported products.

If I could touch on another point in this,

relating to the question of the increase in domestic sales, and also go back to the point you raised earlier regarding competition from imports, I think you did ask what our view was on competition -- in favour of any competition or no competition. I certainly think that Canadian manufacturers are not looking to having insurmountable tariff barriers put around them. I merely mention this because it relates to the matter of increase in domestic sales, where I do feel that as a result of the decrease in the value of the Canadian dollar the opportunities of Canadian manufacturers who have been in production in various products over the last few years -- they are gaining quite a considerably greater share of the national market, and the opportunities are certainly there.

In our business, in one group of products, in 1960-61,27 per cent of the total Canadian national market for these products was imported from the United States. Whilst it is too early to say yet that we will be able to replace those imports to any significant extent, I do think there are signs that Canadian manufacturers themselves are going to be able to take a larger share in that market.

COMMISSIONER GIBSON: Are there any more questions the other Commissioners might like to ask in this sphere? If not, I would like to go on to the question of your responses to monetary policy, the response of the manufacturing industries to monetary policy. We have had some evidence in your

brief in this regard. Table I gives the results of a survey in which you asked: "Which of the following general economic conditions in the country have most influenced your decisions to undertake capital expenditures during the post-war period?" The three conditions are: "Fluctuations of interest rates; tight money during certain periods; depreciation rates permitted under the Income Tax Act."

Frankly, I do not find this table very illuminating because there is no distinction between whether or not you are talking about an expansion in capital expenditures or a contraction in capital expenditures; and it leaves out what I have heard some of you say is a most important factor -- that is, the expected return on capital expenditures. So, I am a little puzzled about what this table actually shows.

MR. POTTER: Well, it is true it does leave out the expectation of profit as an influence on manufacturers. A number of manufacturers wrote in below that they had not marked any of these because the chief factor was the ability to sell a product at a profit or their need to build a new plant. So, it gives rather limited information on their decisions. It does seem to show they figure their cash position influences their investment decisions more than these considerations which arise from monetary policy. That would seem to be a definite conclusion from it. That is not a very broad conclusion and it does not wipe out some other consideratins.

COMMISSIONER GIBSON: One of the difficulties I have is, how does tight money check expenditures in the economy? I have not really got much light on this because you are really asking a sort of general question about decisions on capital expenditures. Your Table 3 does indicate that in the two periods when money was particularly tight recently -- 1956 and 1959 -- the tightness of bank credit did have some effect -- although, here again, it is stated so generally: "Did your firm have difficulty in obtaining desired bank credit in 1956 or 1959?" As one who knows something about one aspect of this business, most people would like a little more credit than they are getting, particularly when money is tight. It seems to me it is such a general question that I am wondering what is the reliability of the results.

MR. POTTER: There was a further question asked: "If so, please comment? Was the line of credit reduced? Was an increase in the line refused? Where else did you obtain the money? How much did it cost?"

This second question was included at the suggestion of the Commission staff, and the answers to that are available, but are not compiled at this time because they did not bear directly on recommendations in our brief. But many firms did indicate what they did in terms of where else they went for money. I can think of a few instances where they discontinued plans for expansion.

COMMISSIONER GIBSON: This is what we would like to get at. Could you give us some opinions as to the relative importance? Let us take a period when money is tight and there is an endeavour on the part of the monetary authorities to restrict expenditures. And also as to what happens when money is easier, when we have lower interest rates and a great deal of credit availability - what is its effect on expenditures?

MR. THOMPSON: We have developed some very general views; I doubt if they are specific enough to be of any help. However, I only state it in very broad general terms, as we see the problem.

I am speaking only of one facet, not so much of tight money, although tight money does mean higher interest rates. The question was, to what extent does high interest rates affect capital investment? The first thing we felt we would have to consider

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is what we discussed at an earlier time, the types of capital investment we are talking about.

If we are talking about capital investment generated from your own internal funds, the general level of interest rates will not have too much effect on investment decisions. It goes without question that if interest rates were 10 per cent or 12 per cent and we could lend money at that rate, it would certainly be an inhibiting factor towards investing money in your own business. But we are not talking about such extremes. In ordinary circumstances, with what we call high rates, 7 or 8 per cent, we would think that for the investment of your own internally generated funds high interest rates do not have too much effect on your investment decisions.

We have to define what we mean by high levels of interest rates, and we feel that an area of 5 or 6 per cent is fairly well accepted, and that interest rates in that area do not very much affect investment decisions. When there is a small fluctuation of, say, 4 to 4½ per cent, or 5 to 5½ per cent, or 6, those are not factors which influence investment decisions.

COMMISSIONER GIBSON: You are talking about investment money over long terms?

MR. THOMPSON: Yes, I am talking about capital investments.

When you get an interest rate higher than 6 per cent we feel that that is a deterrent to capital investment. We qualify that again by thinking in terms of types of companies.

We have covered this ground before, but if you are a small company, having difficulty obtaining funds, you are willing to pay any price in order to remain in business or to get the funds you want. But the larger companies who are capably financed, to them the higher interest rates will have a deterring effect upon their investment decisions. The higher the interest rate, the lower the rate on your equity stock. If you had an interest rate high enough, it could absorb all your profit and there would be nothing left. Under those conditions, the decision would be self-evident - you would not make an investment decision under those conditions.

COMMISSIONER GIBSON: So, you might at times postpone a capital expansion programme because the cost of it would cut far into the dividends and make it uninteresting.

MR. THOMPSON: It would reduce the rate on your equity, and it would not be considered satisfactory. It would have a depreciating affect on the value of your equity stock. The equity stock would have to give a higher return; you would not be inclined to sell your equity stock in competition with high money rates.

COMMISSIONER GIBSON: Not if the equity stock was strong at the time.

MR. THOMPSON: Is it possible that you would have strong equity stock, if you had high rates - ?

COMMISSIONER GIBSON: Yes, it is possible.

MR. THOMPSON: Again, you would have to decide

what you would be getting for your equity stock. But that situation is unusual.

COMMISSIONER GIBSON: We had this in 1959 -- a very strong stock market and high interest rates.

MR. THOMPSON: We had interest rates running to 6 per cent or 6½, but we did not get into 7 or 8 per cent rate. So, we have given a rough yardstick here of an area of 5 or 6 per cent, but anything beyond that does have an effect on capital investment.

There is one side issue, and that is that the higher the cost of the money the more it costs to finance instalment sales, such as housing, automobiles, electrical appliances and all the variety of products that are now sold. We feel that to some extent very high carrying charges would also be a deterrent to the distribution of goods, and that would back up to the manufacturer where he would not be able to produce his product. That condition would be a side effect of high interest.

I think in general that is a fair summary of our thinking.

COMMISSIONER GIBSON: The effectiveness of interest rates, I take it, would vary with interest, capital, labour and profit?

MR. THOMPSON: Yes.

COMMISSIONER GIBSON: The bigger the capital content, the more effective the rate of interest?

MR. THOMPSON: Yes. In an industry with heavy capital investment it would be a greater deterrent than it would be to a secondary manufacturer who did not

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have a high capital component.

COMMISSIONER GIBSON: Is it that the interest rate has gone up, or is it possibly that people expect it to stay up, or to go higher, that is the most important factor in that picture?

MR. THOMPSON: I think the first concern would be if our interest rate approached a figure above 6 or 7 per cent, it would be on the basis of deferment - to wait and see how long it stays that high. If the project period continued and it remained high, we would accept it as a fact of life and try to learn to live with it.

COMMISSIONER GIBSON: If the interest rate was 5 per cent and people expected it to go a good deal higher and expected a tight money policy to set in, would they rush in and get money while the going was good, or would they say, "Money is going to be more expensive - we will hang on".

MR. THOMPSON: I think today if a company with good management felt there was good prospect for capital two or three years hence, and the money market was favourable, and it felt the interest rate was going to rise, the company would finance ahead.

COMMISSIONER GIBSON: And in that way it would get pushed higher.

MR. THOMPSON: Yes, if everybody did that.

COMMISSIONER GIBSON: And how about the availability question? In the two periods of tight money we had in recent times - 1955-1956 and 1959 - some questions have been raised about how available the money

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was, particularly bank credit. Has this had a significant effect on business decisions?

MR. THOMPSON: We think that again depends largely upon the size of the organization. We don't think the availability of money is a factor with major corporations. It definitely has an effect on medium and smaller companies, I believe. I don't think there is any corporation of a national character that has postponed any project that it really wanted to do because it was unable to get its funds. I would be surprised if that were so.

MR. COLLINGE: Are we not begging a deeper question? Apart from the special cases we talk about where funds were available from the company's earnings, and in one or two special cases where raw material was being secured, such as in the Ungava iron ore deposits, I don't know of any decision that has to do with major development that has not been based on an expected return of capital. The day when the expected return on the capital is less than the interest rate, you don't do anything.

MR. THOMPSON: We said that by implication, that if your interest rate, per se, went up to such an extent that it absorbed all of your profit and left nothing for equity, there would be no investment. It becomes a matter of degree. If it goes up to 8 per cent, it might wipe out a portion or all of your equity return. There is a balance factor there which the individual company would have to look for. That could be balanced against its traditional

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earnings ratio that it had in the past.

MR. COLLINGE: Do we not basically use borrowed money to increase the risk of profit and loss on equity capital? Is that not our basic philosophy?

MR. THOMPSON: When you borrow money to put into capital investment you look at what you will have to pay for that money, and what is left over is your profit, and that is what you are going to get; it is the return that will be related to your equity capital.

MR. COLLINGE: But whether you borrow much or little depends on the expected return on equity stock. This is a basic controlling factor.

COMMISSIONER GIBSON: Presumably the bigger the capital investment the closer the calculation between what the money is going to cost and what the expected return is?

MR. THOMPSON: And that what is left over would give a satisfactory earnings ratio for your stock.

COMMISSIONER GIBSON: On the other hand, many investment decisions are made with a fairly decent margin between these two facts - their forecast.

MR. THOMPSON: That is your safety factor.

COMMISSIONER BROWN: That is, this 14 per cent to 20 per cent that you discussed earlier?

MR. THOMPSON: They don't always materialize, but you start out with high expectations.

COMMISSIONER BROWN: On this very point, if you are estimating at 20 per cent --

MR. ROTHWELL: That is 20 per cent before tax.

COMMISSIONER BROWN: Before tax?

MR. ROTHWELL: Yes.

COMMISSIONER BROWN: How much difference is there between that and 6 or 8 per cent interest rate?

MR. ROTHWELL: It might be enough to wipe it out. Business will only expand and make these investments for one purpose, and that is to earn a profit. The expected profit is the result of the calculation of the various factors - all the cost factors as against the income factors. The interest rate is one cost factor in that picture, and it could be that many of these projects are margin projects; some of them offer great apparent rewards and some offer rather low apparent rewards. For everything that pushes up cost just one more notch, it will cut off some of these marginal undertakings. So, no one can say with certainty that a change of one per cent in the interest rate will, of itself, inhibit capital spending, yet we do know it will automatically cut out some marginal projects and therefore reduce capital spending to some extent.

COMMISSIONER GIBSON: Or lead to postponement.

MR. THOMPSON: Dealing with simple figures - and business is never quite as simple as this - assuming you want 20 per cent, you go and borrow for this project at 6 per cent. That leaves you 14 per cent, or after tax, 7 per cent. If your objective earnings on your capital is 10 per cent you might say that is a dilution of the earnings and refuse to go ahead with the project under those conditions.

COMMISSIONER MACKINTOSH: The influence of

high interest rate would be reinforced, if not doubled, if in addition to the interest rate being high you had reason to expect that in eighteen months it would be considerably lower?

MR. ROTHWELL: That is correct.

MR. THOMPSON: I think I said earlier that we are accustomed to a 5 or 6 per cent relative cost of money, and I don't think that the difference between 6 per cent or 6½ per cent would deter too many business judgments. But if it got into an area of 7 or 8 per cent, I think it would cause a postponement of decisions until one was quite sure that the rate was a firm one. If the indications at that point establish it as the new interest rate level, you would have to accept it as an additional cost of doing business and learn to live with it.

COMMISSIONER GIBSON: If you thought this was a temporary situation you would be apt to postpone the project and look into it as soon as the interest rate went down.

MR. THOMPSON: That is right.

COMMISSIONER GIBSON: This leads to the question of how it works the other way, when interest rates decline. Would you care to say a word about that?

MR. THOMPSON: I think it would produce a more favourable climate for investment, and provided the business opportunities were there and money could be obtained on reasonable terms, it would be a factor for determining a decision to go ahead.

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COMMISSIONER GIBSON: You said, provided business opportunities are there. It is not a big enough factor in itself?

MR. THOMPSON: In itself it would be a factor. You must not feel that these decisions are made basically on this one point alone. It would only be considered as one element in a decision.

COMMISSIONER GIBSON: If you had postponement in a boom time because of high interest rates, a decline might bring new expenditures in fairly rapidly?

MR. ROTHWELL: That is correct.

COMMISSIONER GIBSON: How about inventories? What effect would the interest rate have on inventories?

MR. THOMPSON: It has a definite effect. It is going to cost more if you have to borrow money to carry inventory and accounts receivable. You might hold back on that, because of the high cost of carrying it from an interest point of view. I believe it would have a bearing on the accumulation of inventories.

COMMISSIONER GIBSON: When you say money is tight, and it is noised about that money is tightening up, do businessmen take that as a signal that maybe it would be a good idea to cut their inventories back a little?

MR. WILLS: Yes, and in doing so you would release funds that might otherwise have to be borrowed in times of high interest rates.

COMMISSIONER GIBSON: It is not just to save the interest cost. Is it not a signal, indicating a

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COMMISSIONER GIBSON: It is not just to save interest cost. Is it not a signal, indicating a

rote of caution, that the high interest would indicate a slowing down.

MR. WILLS: I think it would.

MR. ROTHWELL: I think it is true that a well managed business should try to get by with the minimum effective inventory. If inventory can be reduced significantly, the implication is that the inventory was not well managed in the first place. You will find a very considerable difference between companies in the way they manage inventories. In our company it gets a great deal of attention. Our purpose is to squeeze out all the cash we can get from it; the cash that is lying in inventory doesn't do a thing for us.

I don't think high interest rate would of itself affect the inventory in our company. On the other hand, if a high interest rate indicates or leads to a slowing down in the economy, and that means slowing down in our production, that is a signal that we must cut our inventory as quickly as possible. We are in an industry that requires high inventories because we cut wood months and months in advance of converting it into paper, and if we have to slow down in our rate of sales we are stuck with high inventories. We will cut it as quickly as we can.

COMMISSIONER GIBSON: You are looking for signals.

MR.ROTHWELL: Yes.

COMMISSIONER GIBSON: What signals do you particularly look for, the monetary signal?

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COMMISSIONER GIBSON: You are looking for signals.

MR.ROTHWELL: Yes.

COMMISSIONER GIBSON: What signals do you

MR. ROTHWELL: We read them all. We sit around the table and discuss situations, and sometimes we are very wrong.

MR. WILLS: I think this matter of inventory has a further complication, Mr. Gibson. In times of high money, when you tend to reduce your inventory to free capital, it has an influence on employment.

Many of our businesses are seasonal; our own particular business is quite seasonal, but we try to work on balancing labour out for twelve months of the year. In other words, we don't sell as many devices in the first six months, but we produce as many as we do in the last six months. If you attempt to reduce your inventory and if it becomes that essential to you, you will get into work schedules when you are building up and then you will be laying off people, so it does have a bearing on your conditions.

MR.THOMPSON: That is true, I think, for a number of companies who produce this item off the shelf, and they try to level off production and keep a normal level and will accumulate for this period.

There is one effect of interest rates, and that is that it does at times pose a problem for the relationship between the manufacturer and the distributor. The distributor wants the manufacturer to carry as large a load as he can, and if interest rates are high he may forget to pay the bank and that puts the burden back on the manufacturer to carry the account. However, that is a side effect and maybe is not germane to the discussion.

COMMISSIONER LEMAN: Mr. Gibson asked you what do you think in general would be the result of an inventory policy when higher interest rates came about. Suppose higher interest rates came about which were induced by the monetary authority; that might very well happen at a time when demand is high

and is pushing on supplying, having a lot of manufacturers and others acting in exactly the other way, feeling that this was a time when deliveries were bad and it would be difficult to get raw materials or manufactured products, and would react just the other way and with high inventories despite the high interest rates.

MR. COLLINGE: Yes.

COMMISSIONER LEMAN: So is it easy to generalize on this?

MR. THOMPSON: I think, relating it to what your inventory situation would be in the light of high or low interest rates, you can only generalize it broadly and it may be questionable whether that has much meaning; so much would depend on your manufacturer and your indstury, the type of business you are in and the conditions under which you are producing.

COMMISSIONER LEMAN: Mr. Gibson was asking what you looked at as indicators. Do you generally look at what you think the demand position will be rather than the interest rates ?

MR. THOMPSON: You certainly look first of all at what is your market, what are your marketing plans and how do you expect to participate in these plans, and you prepare your inventory accordingly, and I think the second consideration would be -- I don't think it would be the first consideration -- the general nervousness about the whole situation, coupled with high interest rates.

COMMISSIONER LEMAN: As a related point that falls along the same line, your brief points out that trade credit is a very large segment of the total funds used by manufacturing, and you prove that by giving some figures. Certainly your receivables are above bank loans, and I was wondering if you could tell us why, in fact; maybe this is a case where small business comes into its own. Apparently at a time of tight money trade receivables tend to go up. Is this a time when small businesses manage to get a lot more credit from large businesses, is that the effect of it?

MR. THOMPSON: I think again it would depend upon the industry. If he is a manufacturer and has a distribution system, he has to supply his distributors and I think he would be highly embarrassed by the distributors falling back on him as a means of credit, but the manufacturer -- often his only source of materials, which is his principal form of trade credit, might be from importing materials, purchasing the basic raw materials, and I don't think in these purchases of basic materials a manufacturer would lean too heavily on his primary source of supply; not to the extent that you have in distribution.

MR. KEAVENEY: You mentioned would a period of tight money and high interest rates be reflected in more receivables being outstanding and would the reverse be true were conditions otherwise. This is true, but when conditions do change back you never get back to the same position you were in before.

Going back some six years to 1956, the first period of tight money, many manufacturers supplying distributors in the retail trade had an average number of 55 days in receivables outstanding. This lengthened to 65 days.

Now, in our case our standard terms of payment are 30 days and several of our larger customers, who are financially stable, adhere to these terms. Many other customers who, nevertheless, account for a large part of our volume, take advantage of every day they can get and this has become really a competitive factor. There is nothing you can do about it. Other companies in the business are doing exactly the same thing and the number of days' receivables outstanding lengthens all the time and a lot, in fact, is outstanding. The customers are leaning on their suppliers instead of the bank and this has/had a very marked effect, I feel, over the last few years on the working capital requirements of manufacturers. They have to have more working capital and, in addition, they have been faced with additional cost factors because of higher interest charges.

COMMISSIONER LEMAN: Once they have learned to lean on their suppliers you can't take them back into the banks?

MR. KEAVENEY: To a very slight degree only. There are measures you can take, but you could certainly never get them back to the position you enjoyed before.

There is a related sphere which I would like

to mention. What we talk about is trade credit and what your customers owe you. I would like to refer to a parallel field where manufacturers engage in the manufacture of heavy capital equipment or custom built equipment. It is the usual pattern for a manufacturer to receive progress payments.

Now, five or six years ago it was quite customary to receive some payment during the course of manufacture, even on an order for $20,000 or $30,000 where the order covered a particular piece of custom built equipment.

Conditions have been so difficult for some, and I refer particularly to the smaller utilities and municipalities, that now it is not at all unusual to take an order for $80,000 or $100,000, which isn't due for delivery for six or nine months, and you get no payment at all until 30 days after the equipment has been delivered, and this change in pattern of progress payments to a more unsatisfactory pattern-- as far as the manufacturer is concerned -- has had a very marked effect on the amount of working capital these manufacturers have had to find.

I think also that a continuation of this could conceivably result in perhaps some of the smaller manufacturers making this type of equipment being precluded from a section of the market or being limited in the number of jobs that they could bid on because they just might not have the over-all financial strength to carry this kind of thing.

COMMISSIONER GIBSON: I have one more broad

question which I would like to try on you, and this is a question on how you feel about your liquidity, about your attitude towards spending and when you are in debt and out of debt. In other words, do you feel that your liquidity is impaired when you have substantial bank loans or substantial loans from the short-term money market; would this be a factor hanging over you and bringing you to the stage of not going ahead too fast?

MR. ROTHWELL: I am not so sure I fully understand the question.

COMMISSIONER GIBSON: Let me develop it a little more.

MR. ROTHWELL: Yes.

COMMISSIONER GIBSON: We are interested in the things that lead businessmen to go ahead and spend money for capital purposes, or to defer such spending, and one of the things that is supposed to have an effect on his attitude is his state of liquidity; is he in a reasonably liquid position or is he not? You are in a reasonably liquid position where you have a good balance at the bank and maybe have some money out on the short-term market, but you are not in such a liquid position if you owe the bank a lot of money and possibly borrowing heavily on the long-term. What we are interested in knowing is how attitudes towards spending change with varying degrees of liquidity?

MR. ROTHWELL: Thank you. I think the answer to that, of course, is the answer in business

philosophy and which is going to vary from company to company.

I can name all sorts of big companies that carry as a usual course substantial bank loans. There are all sorts of companies that carry substantial debt and don't worry about it, and there are other companies that are debt free, companies that seldom carry big loans.

In our own particular company we have had a bit of an unfortunate history some years ago and we like to stay liquid, perhaps for this reason alone, and we don't generally borrow from the bank. We don't make our banker too happy!

COMMISSIONER GIBSON: Sometimes you do.

MR. ROTHWELL: Yes, I suppose sometimes we do. We hold it in reserve. At the moment I guess they are quite happy. This is a business philosophy which you are asking for and it certainly differs from company to company. Again I think we are always back to the one motive, which is profitability. If the earnings from a venture are there, most companies will put up with debt and will put up with bank loans and other things if the project has a sufficient return or sufficient attraction.

COMMISSIONER GIBSON: We recognize that, but given a good profitable prospect, two firms -- one that is highly liquid and the other that is pretty substantially in debt -- their attitude will be a little different?

MR. ROTHWELL: Not necessarily; that will depend on the philosophy of the company because a company already substantially in debt has probably got that way by seizing upon these wonderful opportunities and the seizing upon one more and the taking on of some more debts probably will not disturb them a bit.

COMMISSIONER GIBSON: Doesn't he reach the point where he gets a little nervous and says ---

MR. ROTHWELL: Yes, there must be such a point, but you have to really get down to the individual company because again there may be some other company that is very comfortable, it is liquid, it is comfortable and likes it that way and it will pass up an opportunity only because it doesn't want to get in debt of any kind, it prefers to stay liquid.

COMMISSIONER GIBSON: There are these marked differences between companies which arise out of their historical background and the attitude of their senior officers, and so on; still at any given time businesses become more or less liquid, and when they become less liquid these decisions tend to be checked?

MR. ROTHWELL: I think that is broadly true.

COMMISSIONER GIBSON: If it is a firm that is pretty illiquid maybe there is a point beyond which it doesn't want to go?

MR. ROTHWELL: I believe that is true. I think that the condition of the company would

have some bearing.

COMMISSIONER GIBSON: Would anybody else like to talk about this?

MR. THOMPSON: I would like to add this comment; there is a rule of thumb about how a well managed company should operate, and it is said that you should have cash equivalent to one to two months' sales. I think that is a pretty ideal situation but it is seriously regarded, I know, by a number of very well established American companies, but I think in the larger corporations you go through phases and you are always making your plans and you may for several years accumulate substantial bank loans, knowing that you will go into the market to the extent to which you will get away from this desirable liquid condition, but you will always have your eye on what your borrowing capacity is. I think if you are up to your borrowing capacity you would hesitate about getting yourself into a non-liquid position.

COMMISSIONER GIBSON: It is sort of a maximum of illiquidity?

MR. THOMPSON: Yes, but if you have lots of borrowing capacity, your credit is good on the market, you will go through phases where you will accumulate very substantial bank loans and then plan, when the market is at what you consider a good time to borrow, and having regard to interest rates and other factors,you will go into the market and you will plunge, so you will go through phases.

COMMISSIONER GIBSON: Your ideas about how liquid or illiquid you are will be influenced by how high interest rates are, how tight money is, and presumably when interest rates are high and money is tight you will more concerned about having a lot of debt than you would if interest rates were low?

MR. THOMPSON: You are just talking about this working capital situation?

COMMISSIONER GIBSON: Yes, and long-term debt, too. That is another way.

MR. THOMPSON: If you are taking the total, I think every company has a point to which they know they can safely go and take debt, and there is a point beyond which it is not prudent and after that the funds should be raised by equity or some other means, but there are limits.

MR. WILLS: The present profitability of the business would have a bearing on your position, too, if you were to justify a reasonable profit.

COMMISSIONER GIBSON: If the business is highly profitable you would be willing to tie yourself up a little more than you would otherwise?

MR. WILLS: Yes.

MR. COLLINGE: I think we should emphasize that in our opinion there are no rules. I knew a company that kept getting broker and broker, and if it saw a way to get 10 per cent on an anticipated return it would borrow more money.

COMMISSIONER GIBSON: I am not trying to

suggest there are rules, I am trying to find out if there are any tendencies. This is the right word, I think.

MR. FLYNN: I think it fits. You have to consider the long-term forecast, your projected earnings and the opportunities available for getting a good return on any specific project; I think these all have to be weighed.

COMMISSIONER GIBSON: Yes, other things being equal; the fact of being liquid is of some importance in whether or not you go ahead and spend money.

MR. FLYNN: I would think, depending on the long-range forecast that the immediate liquidity would be secondary or even the least consideration. It is some.

MR. THOMPSON: Providing you had good acceptance for your securities. If you start going into a loss position ---

COMMISSIONER GIBSON: That is the point; a company gets to the point where it is up to its maximum bank credit and it realizes it can't get any more credit and when it doesn't feel it can borrow any more money in the long-term bond market, surely that will have some effect.

MR. THOMPSON: That could be a factor!

COMMISSIONER GIBSON: That is an extreme case, but presumably/there is something in between the two?

MR. THOMPSON: I think that only company philosophy is in between.

COMMISSIONER GIBSON: I think that is all, Mr. Chairman.

THE CHAIRMAN: There is just one question which I want to ask and it arises out of your comment about the securities legislation. I understand that you would like to see a more uniform method of dealing with it, but the point I wish to raise in connection with your views as to full disclosure in the prospectuses and the shareholders' reports, that they have to be filed either with the stock exchange or the Securities Commission, which also involves disclosure of the financial affairs of the company, and I would like to know your views about full disclosure. What would you think would be the sort of disclosure that is required to give a fair picture of the affairs of your company to the public who might be interested in it either as purchasers of shares or in some other way?

MR. THOMPSON: Just dealing, first of all, with the broad subject of disclosure -- I am not speaking of prospectuses here -- we feel that there is adequate disclosure at the present time by public companies. This pressure for disclosing information is brought about by the necessity of public companies having to obtain their funds in the market-place. As long as we are acquiring funds in the market-place, and people are willing to give us the money on the basis of our present disclosure of information then I think that is sufficient. If you are talking about the public interest then we do not think it is fair to single out companies that are public companies that have to go to the market-place for financing. If there are to be any rules with respect to disclosure, they should pertain to all companies, except, perhaps, the very small organizations, so that we are all on a comparable basis. We do not think it is fair legislatively to pick out those companies which have to go to the market-place to obtain funds by means of equity stock or funded debt , and say to them: "You have to give a whole lot of information, but if you do not go to the market-place you do not have to divulge anything."

THE CHAIRMAN: The companies you are speaking of would be companies that would have a substantial number of shareholders? You are not concerned with the family corporations?

MR. THOMPSON: Not the smaller type of company, but I do not think the attention should all be

directed to companies who happen to be in the market. I do not think you should say to such a company: "You have to tell the public the whole story, but your competitor who may be ten times your size is not required to make a disclosure simply because of an ownership arrangement".

So long as the amount of information that we do disclose to the public is satisfactory for our purposes, in that it enables us to finance satisfactorily, then I think that that is satisfactory to the market-place, and we do not need legislation.

COMMISSIONER MACKINTOSH: If it is satisfactory to your shareholders?

MR. THOMPSON: Yes.

MR. DOBBIE: We feel it is, in essence, a matter as between the company and the shareholders and the market-place, and that it should not be legislated upon.

MR. THOMPSON: We are not advocating that all companies should do this, but if you are thinking of minimum disclosure by public companies then we think you should not discriminate against the public companies and that the legislation should apply to all.

THE CHAIRMAN: We have had representations from the security analysts who say that the present sort of disclosure is inadequate; that it should be much more detailed and that statements should be issued much more frequently than they are at present.

MR. THOMPSON: I think I heard it expressed this morning that if we could give them a day-to-day

statement of profits they would then be satisfied.

COMMISSIONER BROWN: Would you not agree that shareholders are entitled to the information that is given in the prospectus when an offering is made on a continuing basis?

MR. THOMPSON: They have that information made available. They have it in the annual report.

COMMISSIONER BROWN: It is not always.

MR. THOMPSON: The point we make is that we are able to market our securities under these conditions, and if the people we sell those securities to are not satisfied then they do not invest further in our securities and that will force us to give further information, but, we feel it is a matter as between the corporation and the investors themselves. We do not feel it is an area for legislation.

COMMISSIONER BROWN: My point is that the investor who gets the information to start with is entitled to feel that he is going to get the same kind of information. You say it is available, but that is not quite correct because there have been cases of a bond issue by a company which later becomes a subsidiary of another company and stops issuing statements. In such a case the purchaser has lost some of the information which was available to him and which he assumed was going to be available to him.

MR. THOMPSON: His rights are written out in the deed itself. He has a trustee, and the trustee acts on his behalf.

COMMISSIONER BROWN: In practice it does not

work out in that way.

MR. ROTHWELL: On the balance I believe our company makes quite full disclosure and yet we have people who tell us we do not make full disclosure, so the question of disclosure is apparently subject to a lot of things. I have been told many, many times by investment analysts, and so on, that we are at fault because we do not publish earnings quarterly. We do publish half-yearly, but not quarterly. Strangely enough, we get no pressure from our shareholders, generally speaking, for quarterly reports at all. They seem fully satisfied with the half-yearly reports so we think that maybe this pressure for quarterly reports comes from the professionals rather than from the shareholders.

COMMISSIONER MACKINTOSH: You pay dividends quarterly?

MR. ROTHWELL: Yes.

COMMISSIONER MACKINTOSH: That keeps the shareholders happy.

MR. ROTHWELL: I believe the standards of disclosure are, generally speaking, higher than the professional analysts seem to think they are. But, I believe primarily that a company which does not make adequate disclosure is hampering itself in the market-place -- that is, when it goes out to borrow money. If it can borrow money with a minimum of disclosure -- perhaps that minimum of disclosure is made for competitive reasons -- it is pretty hard to say that a company should disclose more when, after all, people will lend money on the basis of the minimum disclosure. I think that most Canadian public companies are doing a pretty fair

job in this field of disclosure and, I think, perhaps, they deserve a little more credit than is given them.

COMMISSIONER MACKINTOSH: Do you not think there is some illusion about this? Long ago I worked with Mr. Willis George on that same problem, and I usually found that I could get very good disclosure by going and asking one of your competitors.

THE CHAIRMAN: Gentlemen, that appears to be the end of the questioning. I wish to thank you very much indeed for your co-operation, and the discussion we have had. It has been of very great interest to us and we do appreciate it.

I just wish you to know how deeply we appreciate everything you have done to help this Commission both in the preparation of your brief and in your attending here today in such a large number.

MR. DOBBIE: Thank you, Mr. Chairman and Commissioners. Commissioner Gibson, we will have the results of the whole questionnaire made available to you.

MR. POLLOCK: Mr. Chairman and gentlemen, may I say that I think Mr. Rothwell struck a very pleasant note when he spoke of the atmosphere of this meeting. He said that he found the discussion so interesting that it was difficult to stop talking, and I think the other members of our delegation feel the same way.

On behalf of our delegation I thank you for the welcome you have given us in this matter, and also for the interest you have displayed in our presentation. The work our own members have

done makes us realize what a tremendous task faces you gentlemen in analysing, criticizing and finally synthesizing all of the presentations that are made to you.

So far as we are concerned, we have certainly learned a great deal from your questions, and you have prompted our thinking. We appreciate that very much. Therefore, on behalf of my delegation, I thank you very much for hearing our presentation. We will look forward to your report trusting that while framing it you will be thinking of the interests of the members of the Canadian Manufacturers' Association.

THE CHAIRMAN: We shall adjourn now until tomorrow morning at 9.15 when we shall hear Professor J.Viner.

--- Adjournment.

Royal Commission on Banking and Finance

THE CANADIAN MANUFACTURERS' ASSOCIATION

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The Canadian Manufacturers' Association

87 Yonge Street,
Toronto 1, Ontario

August 20th, 1962.

The Honourable Dana H. Porter, LL.D.,
Chairman, and Commissioners,
The Royal Commission on Banking and Finance,
Ottawa, Canada.

Gentlemen:

1. The Canadian Manufacturers' Association welcomes this opportunity of making a submission to the Royal Commission on Banking and Finance. Manufacturers are vitally affected by the workings of the monetary and fiscal system and of the capital market and, since some of the matters under study by the Commission have long been of interest and concern to industry, the Association was prominent among those advocating the establishment of such an enquiry.

2. The Canadian Manufacturers' Association is a non-profit, non-political organization of more than 6,000 manufacturers in every branch of industry in Canada, joined together to consider and take action on common problems. Its membership in some 600 communities from coast to coast includes concerns of all sizes, three-quarters of them employing fewer than 100 persons. In total, the members produce about 75 per cent of Canada's total manufacturing output. The Association speaks not for big industries nor for small industries, nor for regional or sectional interests, but for manufacturing as a whole.

3. Manufacturing, it might be noted, provides the job of one out of every four employed Canadians, so that

the Association represents a very large segment of the national economy.

4. In the ensuing observations and the main body of its submission the Association should be understood to be commenting not only on current conditions but also upon past situations which may recur and upon matters of general principle. The scope of the discussion is rather selective, since comments have been made, for the most part, only on those matters in respect of which the Association would like to see some change made in legislation or practice.

5. The field of monetary and fiscal policy is left largely to others with a more specialized knowledge of it. The Association would, however, like to affirm what it believes should be the goals kept in view by the authorities, insofar as either type of policy is applicable: economic growth, economic stability, the avoidance of price inflation, a suitable foreign exchange rate, and the minimization of unemployment, both of manpower and productive capacity. The Association is concerned that governments should be especially vigilant in restraining their spending at times of restricted credit conditions, so as not to compete unnecessarily with private business for funds.

6. Because such a large portion of the funds for the expansion of manufacturing activity comes from retained earnings, the Association considers the question of income taxes to be highly pertinent to any discussion of the financing problems of industry. Taxes are too high for the short-term or the long-term development of

the Canadian economy, and it is recommended that they be reduced to provide more capital for industry and to heighten the incentive to invest, as well as to help maintain competitive costs for our national production. Reducing the tax load will, it is submitted, increase the tax base.

7. It is pointed out that the rise of the European Common Market and other trading blocs and the determination of the United States to expand its exports mean that Canadian exporting and import-competing industries will face an intensified necessity of remaining competitive in the years ahead. One facet of this problem will be the need for an adequate supply of capital at reasonable cost. This longer-term challenge thus increases the importance of Canadian manufacturers having income tax treatment suitable to their competitive situation.

8. For the same reason, capital cost allowances, which are more generous in some other major industrial nations, should be liberalized in Canada. In addition, the practice of some other competing industrial countries in granting investment allowances, that is, tax credits over and above normal or accelerated depreciation, should be adopted in Canada.

9. The Association urges thatCanada's national affairs be so ordered as to attract and hold the foreign capital that the country will surely need upon occasion. Such a policy would involve the maintenance of a stable, sound economy, a minimum of government interference in the workings of the market place, and the acknowledgement

that both foreign and domestic capital play a constructive role in our material and social progress and in providing gainful employment for our population. At the same time, government fiscal and economic policies should always be calculated to enable the maximum generating of capital in Canada itself to reduce to a corresponding extent our need for foreign capital.

10. If there is one general, encompassing principle which the Association would state as summarizing its views about the capital market, it is that the alternative sources of funds for industry should be broadened. These alternative sources are now limited by legislative and customary restrictions and it would seem that some of these could be eased or removed.

11. As part of such a broadening of the sources of capital, chartered banks should be permitted to lend on mortgages on industrial real estate and equipment and a maximum interest rate on such loans should be permitted which would make them attractive to the banks. Also, study should be given to the possibility of liberalizing the legislative restrictions upon the investment powers of insurance and trust companies so they may invest more freely in common stocks.

12. In this connection, there is an unfavourable trend affecting the financing of industry. That is the growth of types of pension funds which are committed to investing according to restrictive rules which discriminate against or prevent investment in industry. There are large amounts of pension funds in insured plans, which, with the exception of segregated plans, may not

place more than 15 per cent of their assets in equities. None of the assets of pension funds invested in government annuities are available to business and industry.

13. It is strongly recommended that there should be no national "second tier" pension plan, which would, in addition to increasing production costs, tend to "socialize" savings and further accentuate the channelling of funds away from industry.

14. The availability of investment funds to manufacturing companies would be increased if more of them were able to issue securities to the public. Cost is often a barrier here, however. It is suggested that the most practical steps toward lowering such costs would be the final achievement of uniformity of securities and companies legislation by the various jurisdictions in Canada and permitting the deduction of underwriters' and dealers' commissions as expenses for income tax purposes.

15. It is generally recognized that one of the keys to national growth is an expansion of exports. The expansion of exports in the present-day world is, however, increasingly a problem of providing the type of financing which the development of export markets requires.

16. This subject is discussed extensively in the submission and some specific suggestions made for improvements. It is suggested that further study should be given to the need for re-discount facilities for insured short-term export paper where recourse would be limited to the exporter's 15 per cent share under the

co-insurance principle. Export credit insurance premiums, which are a significant item in the cost of exporting, should be reduced as much as possible. Changes in coverage are suggested, as well as the exemption of the Export Credits Insurance Corporation from income taxation.

17. In addition, various other matters not included in this summary are mentioned in the submission. For instance, manufacturers reported several problems with the Industrial Development Bank which are brought to the Commission's attention.

18. Background on various aspects of the subject matter of the main submission and related topics is presented in a series of appendices, some of it based upon results of a questionnaire which the Association circulated to its members in preparation for this submission.

19. We look forward to the report that will follow your investigations and labours and the important and beneficial changes which it will doubtless foreshadow for the financing of industry.

Yours very truly,

C.A. Pollock,
President

J.C. Whitelaw,
Executive Vice-President
and General Manager.

MONETARY AND FISCAL POLICY

20. The Association's interest in monetary and fiscal policy centres on what it would like to see achieved or avoided in the economy and on the co-ordination of policies so as to prevent harmful effects on the business community. There are some highly technical aspects to monetary and fiscal policy, including the question of how effective these instruments can be attaining their objectives. These questions are left to the Commission and those appearing before it with a more specialized interest in, or knowledge of, such matters.

21. If the Association may state what objectives manufacturers would like to see monetary or fiscal policy pursue, in so far as either is applicable to such objectives, these may be summarized as follows:

(a) Economic growth. Monetary and all other government policy should always put the expansion of domestic production and domestic and export markets in a place of prominence among the various objectives that must be reconciled.

(b) Economic stability. While growth is desirable, overexpansion, with a subsequent contraction and disorganization of production, losses to the economy and increased business failures, is to be avoided.

(c) The avoidance of price inflation. It is recognized that Canada cannot be

insulated from the effects of inflationary forces in other countries, but it is vital that prices of Canadian-produced goods should not increase more than those of competing producers and if it is possible to restrain price increases below those in other countries or to avoid them entirely, without occasioning undesirable deflationary effects, this should be sought. The Association regards wage increases not directly related to an equitable sharing of increased productivity as having been in practice a more important source of price inflation in Canada than unjustified expansion of the money supply. But inflation from either cause, or from higher levels of taxation, must be avoided.

(d) The maintenance of a suitable foreign exchange rate. The foreign exchange rate has very important effects on the competitiveness of Canadian-produced goods in both domestic and foreign markets. With a fixed exchange rate, it will now be essential to keep monetary and fiscal policy from causing balance of payments difficulties.

(e) The avoidance of unemployment, both

of manpower and productive capacity. Actually, this goal will tend to be achieved if those of growth, stability and the avoidance of inflation are successfully pursued.

22. In earlier days deficits by governments were regarded with rather general disapproval. Now the pendulum has swung to the other extreme; the public and government are in danger of forgetting that even if it is safe or desirable to have an unbalanced budget for a period, a prolonged succession of deficits can bring an unhappy day of reckoning in the form of balance of payments difficulties, inflation, unemployment and other ills.

23. There is a legitimate place for budget deficits and for the growth of the public debt, within the limits imposed by the growth of the economy and the ability to carry debt. But fiscal policy must harmonize with the sound management of the nation's affairs and must not lead to dangerous monetary expansion and inflation.

24. Indeed, fiscal policy must be quite closely co-ordinated with monetary policy. It is unsuitable for government to expand its spending and borrowing while the monetary authorities are calling upon business to restrain its expansion and implementing this imperative through a tightening of credit.

25. Government should not initiate programmes involving heavy expenditures which would, through borrowing or taxation, hinder the ability of Canadian industry to make necessary capital expenditures at

crucial periods in industry's development and in the evolution of its competitive position vis a vis foreign producers. (It must be observed that it is not only expansions of government expenditures at inopportune times which pose a problem, but also the continuing, long-term high level of government expenditures. However, since this fundamental question lies outside the field of fiscal policy, it is dealt with elsehwere in this submission).

26. It is realized that periods of restricted credit are sometimes quite necessary. But any more credit restriction than is necessary is a danger to the short-term and long-term welfare of industry, and such restrictions, whether necessary or not, always face many manufacturers with serious problems and may do permanent damage to some firms. Some of the difficulties which periods of restricted credit can produce for manufacturers may be summarized as follows:

(a) Canadian industries compete with those located in other countries. If credit restrictions restrain the expansion of Canadian output, producers of imported goods with sources of financing in their own countries may as a result expand their foothold in the Canadian market, something which may have lasting effects where established relationships with customers are important.

(b) Similarly, credit restrictions can face exporters with either a loss of export

markets to foreign competitors or with an inability to expand their share of export markets as they should. Here, again, lasting effects are possible.

(c) Since some firms manufacturing in Canada have access to financing in other countries through their corporate affiliations outside Canada, those firms which lack such affiliations may find their competitive situation in the domestic market affected adversely by credit restrictions. While special advantages for one class of firm are not advocated, special disadvantages are undesirable, but can arise from restricted credit conditions.

(d) Also, manufacturers sometimes find themselves called upon to act as bankers to their dealers when the chartered banks are less able to perform this function because of credit restriction. This is burdensome to the manufacturer, who is not a specialist in granting and administering credit as the banks are. Also, it places an additional demand upon the manufacturer's own finances at a period when the firm may itself be experiencing difficulty in meeting its own financial needs.

(e) Some manufacturers find that the

calling of bank loans in periods of restricted credit poses especially severe problems because their business cannot easily be contracted as quickly as a retailing or distributing business. Such manufacturers need to be able to count on their financing for a period further into the future than banking practice, subject to sudden changes in the policy of the Bank of Canada, contemplates. It is believed that this fact discourages some manufacturers from using bank credit that would otherwise be helpful to them and thus to the economy.

27. In considering periods of slackness in the business activity, it is urged that government expenditures intended to stimulate the economy should be used with care lest they tend to produce avoidable inflation or introduce spending programmes that may prove difficult to eliminate or reduce when their stimulating effect is no longer required.

TAXATION, CAPITAL COST ALLOWANCES AND INVESTMENT ALLOWANCES

28. Since retained earnings are ordinarily the largest single source of funds for the expansion of manufacturing activity and since taxes take such a large share of corporation earnings, the most immediate and practical way of increasing the availability of investable funds in industry is through a reduction in taxes. The Association, therefore, views the subject of tax rates as being highly relevant to a discussion of the financing problems of industry.

29. Income taxes are at too high a level for either the short-term or long-term development of the Canadian economy. It is recommended that these taxes should be substantially reduced as a means of stimulating an overdue expansion of the economy, which in turn would increase the tax base.

30. The manufacturing industry of Canada is taxed at very high rates. Moreover, the income received by manufacturing corporations is subject to taxation tiwce -- first as income of the corporation itself and secondly when the profits remaining after the tax is paid are received by shareholders in the form of dividends. Although there is a shareholders' dividend tax credit, this bears a small relationship to the top corporation tax rate of 50 per cent or 52 per cent.

31. High corporation tax rates are harmful to the economy since they reduce the amount of funds available to manufacturers for the purchase of modern machinery and the expansion of industries. By reducing the amount of funds so available and by making anticipated after-tax

profits from investments lower than they would otherwise be, high tax rates are a discouragement to industrial investment.

32. The slowing down of the rate of national growth in recent years is generally acknowledged to be associated with the slackening of the pace of investment. While this slower rate of investment is conditioned by other factors besides the amount of internally generated funds available to manufacturers for possible investment, this supply of internal funds is an important factor in determining the volume of investment. Even though slackness of demand and the existence of overcapacity do overhang a number of key industries, there are others where these conditions are not nearly as noticeable and even where the basis for expansion has in recent years appeared to be good, setting aside cyclical variations.

33. Thus lower tax rates and consequent higher after-tax profits would offer an important degree of stimulation to the economy through the provision of more investment funds and through the prospect of higher returns, after tax, on new investments.

34. The highly progressive personal income tax rate structure is also one of the factors militating against new capital formation in Canada. If we feel that it is in the public interest that Canadians should purchase, develop or create industries, we should not have punitive taxation make the achieving of this objective difficult or impossible.

35. The Association favours an examination of the tax structure and its impact upon capital formation and

incentives, but feels that a reduction of the overall level of taxation is the more fundamental and urgent need. Since government expenditures cannot for an indefinite period exceed government revenues by any wide margin, this implies a necessity for a lower level of government expenditures.

36. In regard to ways in which government expenditures could be reduced, the Association is pleased to acknowledge the work of the Royal Commission on Government Organization and expresses the hope that its recommendations for economy in government will be promptly implemented.

37. If Canadian industry is to be competitive with foreign producers, we must avoid placing it at a disadvantage through taxation rates. Information on comparative taxation rates is given in Appendix II (and this subject is also referred to below in a section dealing with "Foreign Capital in Canada"). The competitive danger lends urgency not only to action on rates of taxation but also to measures that provide relief from taxation, that is, capital cost allowances and investment allowances, which are dealt with below.

38. It is recommended that tax incentives, including increased capital cost allowances, should be further expanded as a means of encouraging national development and providing employment. While the additional capital allowances in respect of new products and the re-equipment and modernization allowance which have been established are desirable and a step in the right direction, it is submitted that these capital cost allowances constitute an insufficient incentive to achieve the desired results.

It is considered that capital cost allowance provisions less restricted in their application and providing greater incentives, should be established.

39. In many of the countries of Europe, normal depreciation allowances are supplemented by "initial" or accelerated depreciation allowances and sometimes also by investment allowances. An initial allowance is accelerated depreciation which is granted usually in the year the asset is acquired and which has the effect of making possible a faster recovery of the original cost of the asset. On the other hand, investment allowances are in addition to both normal depreciation and initial allowances and do not reduce the depreciable cost of the asset.

40. Initial depreciation allowances are granted in the leading European industrial countries of France, Germany, Italy, Netherlands and the United Kingdom. Forms of accelerated depreciation are also provided in other countries, including Austria and Norway. In addition to specific initial allowances for industrial buildings, plant and machinery, the practice in the United Kingdom is to multiply the normal rates of depreciation by five-fourths in calculating the annual allowance to be granted.

41. Investment allowances apart from normal and accelerated depreciation are granted in the Netherlands, Belgium and the United Kingdom. In the Netherlands the general rate is 10 per cent, but for ships and airplanes it amounts to 16 per cent, in both instances being spread over two years. In Belgium the investment allowance

amounts to 30 per cent, but is applied only to supplementary investments, that is, the increase of new investments over the total of disinvestments and depreciation on old assets.

42. In the United Kingdom there is an interrelation between investment allowances and initial allowances, the effect of which is that on new machinery and plant the taxpayer is entitled to an investment allowance of 20 per cent, plus a 10 per cent initial allowance.

43. Capital cost allowances, including normal and accelerated depreciation allowances, and investment allowances should, in the opinion of the Association, be established in Canada on a basis comparable to those which are in effect in many European countries. Most of the leading European industrial countries with which Canadian manufacturers must compete provide more liberal capital cost allowances than those available in Canada. It has been suggested by a well-qualified observer that it would almost appear that a conscious fiscal policy has been adopted by the majority of European countries to allow corporations to deduct capital expenditures as ordinary business expense (J. Barbeau, "Canadian Tax Journal", July-August 1961, page 303).

44. Accelerated depreciation and investment allowances appear to have contributed much to the present efficient state of European industry and have given European producers a competitive advantage over Canadian firms. It is submitted that the Canadian economy would derive corresponding benefit from the granting to industry of accelerated depreciation on a broader and more

liberal scale and by the establishment, in addition, of investment allowances.

45. Details on European incentives are given in Appendix II.

46. The Commission's attention is directed to the lack of uniformity among provincial sales tax acts and between provincial sales tax acts and the federal sales tax levied under theExcise Tax Act. The existing diversity among these acts complicates many manufacturers' financial operations and raises their costs both as taxpayers and tax collectors. This problem would be diminished if the various jurisdictions would introduce a greater degree of uniformity and this action is recommended.

FOREIGN CAPITAL IN CANADA

47. NOTE: At the time of writing, the movements of foreign capital across our frontiers have assumed some critical aspects. The following remarks, therefore, do not refer to such emergency measures as may be required in this crisis, but are concerned with permanent policies on a long-term basis.

48. Canada's production and export trade, while substantial per capita of its population, are small in proportion to its area and its actual and potential resources. In these circumstances, the assistance of foreign capital in the further development of our country, and thus in the reducing of the extent of this dis-

proportion, will probably be a factor of great importance in the future as it has been in the past.

49. By way of emphasizing Canada's need for capital from all sources in the years ahead, it may be pointed out that a study prepared for the Royal Commission on Canada's Economic Prospects forecast that investment expenditures in Canada in 1980 would run to a sum of two and three-quarters to three and one-half times those of 1955, setting aside the effects of price changes. This increase in demand for capital will not all be over such a long run, either, for the study forecasts a 1970 level of investment about two and one-fifth times that of 1955.

50. In moving from its country of origin, capital seeks the highest degree of safety and profit seemingly available. The Association, therefore, urges that this be kept continually among the foremost of those considerations bearing on the formulation of the Government's fiscal and economic policies. If we need foreign money, as upon occasions we surely will, we must order our national affairs so as to attract it and hold it.

51. The foreign suppliers of risk capital, which in the past has contributed so much to the expansion of our economy, look for no safety beyond the assurances which can be provided by the attitudes and actions of our governments. These include responsibility and consistency in budgetary and taxation policies, and a continual shaping of these and other policies to the end of having our balance of international payments impart a stability

to our currency in the foreign exchange markets. They also include acknowledgement by deed as well as by word thatoperating profits, far from being a form of exploitation, are the life-blood of a free economy.

52. Like most benefits, foreign capital has its price, and this is paid not only by way of debt service and the free return flow of earnings to the foreign owner, but also in the inevitable giving up, in some degree, of control over our own economy. The Association, therefore, urges that government fiscal and economic policies should always be calculated to enable the maximum generating of capital in Canada itself, and thus to reduce to a corresponding extent our dependence on foreign capital.

53. The generating of capital in a country is achieved through the retained earnings of corporations and individuals. Speaking for Canadian manufacturing corporations, the Association wishes to point to certain highly relevant statistics. During the period 1950-1961, retained earnings, as a percentage of business volume declined from 4 per cent to 2.2 per cent. Dividends paid to shareholders (a lesser but important source of new capital) experienced a similar decline from 3.1 per cent to 2.7 per cent.

54. The foregoing clearly shows that during a decade of great expansion in Canada, when this country was in such great need of capital as to import it in unprecedented quantities, this potentially fruitful source of home-made capital was forced to wither on the vine. For total taxation, direct and indirect,

collected from manufacturers continued to increase more rapidly than business volume during the same 1950-1961 period and amounts to a considerably larger percentage of business volume than retained earnings and dividends combined.

55. Canada, although a small country industrially, has corporation tax rates at levels as high or higher than most of the leading industrial countries of the world. They are approximately the same as United States corporation taxes and higher than those in effect in some European countries. A recently published study has shown that, on the basis of a typical example, the average of the effective corporate rates of income taxes in Belgium, France, Germany, Italy, Netherlands, Sweden and the United Kingdom is somewhat lower than the corresponding effective Canadian rate. (These figures are reproduced in Appendix II). It is submitted that Canada has need of lower tax rates than its highly industrialized competitors to encourage Canadians to invest and provide employment, thus building up Canada.

56. As well as lowering producer costs and generating additional capital within Canada, tax rates more reasonable in comparison with those of other countries would also help Canada attract such foreign capital as may continue to be necessary.

THE CHARTERED BANKS

57. As a result of limitations on the type of security they may take, chartered banks in Canada cannot easily lend to industry for some purposes for which commercial banks in some other countries may lend.

This artificial, legal restriction on our banks was originally justified because of the danger of insolvency in small or incompetently managed banks. It is submitted that Canadian banks have grown to rank, in most cases, among the world's largest financial institutions and that the standard of general management and branch management in Canadian banking must surely be among the highest in the world.

58. There has been some recognition that bank lending powers are too restricted, but this has made itself felt in piecemeal enlargement of those powers without much consistency or any overall, guiding logic. Commencing some years ago, banks were permitted to lend money to provide a consumer with a new house, but they still could not lend to his employer on a mortgage covering the factory or warehouse that was to make it possible for the consumer to occupy his new house and meet his mortgage payments. Banks were also allowed to lend on chattel mortgages to consumers, but not on the equipment used by the manufacturer to produce the goods sold to the consumer.

59. More recently the effect of the banks' inability to lend on the security of mortgages, except for collateral security, was lightened by the Government's action in providing guarantees for loans to small business for the purchase of equipment, the improvement of premises or a necessary move to new premises.

60. It is submitted that if it is thought desirable that the banks should lend for purposes for which they would feel a government guarantee on the loan was

necessary, they should be able to make loans for similar purposes in any circumstances where the risk would appear to them to justify a loan without a government guarantee, but with appropriate security.

61. In short, banks should be permitted to lend on the security of mortgages on any equipment, machinery or real estate used by industry. It is realized that the making of such loans would in practice be subject to an assessment by the banks of the risk and costs involved and the return available to them; there would undoubtedly be some factors tending to inhibit bank lending of this sort. But in the present advanced state of development of our banking system there are decisions that can safely be left to the bankers.

62. It is also recommended that the maximum interest permissible for such loans be high enough to compensate the banks for the illiquidity of such investments; the appropriate amount for such a rate should be determined by the Commission.

63. It is further recommended that a "basket clause" similar to that in federal insurance company legislation be introduced into the Bank Act permitting chartered banks to place a specified maximum percentage of their assets in any investment of their choosing, without regard to any specific authorization in the Bank Act and in spite of any prohibition in the Bank Act otherwise applying. While it is realized that the Canadian banks of today could probably be relied upon to invest their funds wisely without any legal restrictions, it will probably continue to be wise to

have the investment powers of banks spelled out legislatively, with any reasonable restrictions, so that all may know what role banks are expected to play in the economy. However, a "basket clause" would leave leeway for gradual changes in the practices of banks and for unexpected innovations in financial practices. Having the Bank Act subject to periodic formal review is a distinctive and highly praiseworthy feature of Canadian banking legislation, but it still means that any necessary changes in banking practice may take a matter of years to become legislatively possible. What maximum percentage should be embodied in a "basket clause" is something which the Commission might recommend after a study of the matter by experts.

64. The Association endorses the principle of chartered banks which operate on a nation-wide scale decentralizing their operations as far as practicable so as to bring decision-making above the local branch level as close as possible to the needs and opportunities of the different regions of Canada. The system of nation-wide branch banking which prevails in Canada has given us banks with greater financial strength and flexibility in lending capacity than most of their counterparts in the United States; but it also inescapably tends to remove policy-making from the regional level and places a sometimes very great geographical distance between the borrower and the official responsible for final approval of his loan. Continued, conscious efforts by the banks to compensate for this within their own organizations will contribute

to both the welfare of individual regions and localities and the good will which banks enjoy with the public.

65. Some manufacturers believe that there has been a large growth of firms specializing in factoring and accounts receivable financing and that this points to a possible deficiency in the supply of bank credit to small business. It is recommended that the Commission study factoring and accounts receivable financing to determine whether this growth is of unusual proportions and, if so, whether it is a symptom of an inadequate supply of bank credit to small business or should instead be regarded primarily as a beneficial broadening of credit facilities.

SECURITIES AND COMPANIES LEGISLATION

66. The practicability of public financing would be increased for at least some industrial companies not now able to undertake it if the various jurisdictions would finally achieve uniformity in their securities and companies legislation.

67. In the case of securities legislation, both expense and trouble could be reduced since the acceptance of a prospectus by any one jurisdiction would, with the existence of uniform requirements, make acceptance by other jurisdictions possible with only nominal trouble. There would, of course, be a major saving to all companies in preparing prospectuses and a general simplifying of the whole undertaking of issuing securities.

63. The Association also recommends the enactment of uniform companies legislation by Parliament and the

provincial legislatures. At the present time, aside from the differing methods of incorporation, there is considerable divergence among the legislation of the eleven incorporating jurisdictions on matters such as capital provisions, directors' liability, protection of minority shareholders and prospectus and return requirements. The Companies Acts of many provinces have not been amended in the past twenty-five years, despite the substantial growth of the number of companies operating in Canada and the ever-increasing flow of inter-provincial trade. Today, there are in excess of 65,000 companies incorporated in the Province of Ontario alone, with some 6,000 new companies being formed each year. In addition many provincial Acts do not take cognizance of modern practices, the trend toward amalgamation of companies or the establishment of investment trusts.

69. The resultant confusion, unnecessary duplication and cumbersome procedures occasioned by outdated legislation and lack of uniformity clearly dictate the need for new legislation which is both clear and concise.

UNDERWRITERS' AND DEALERS' COMMISSIONS

70. One of the difficulties besetting manufacturing companies in offering securities, either through public offering or private placement, is the cost involved. Just as Canadian industry has special problems in short production runs, much of Canadian industry has special problems arising from the diseconomies of raising money in relatively small quantities. Even for large companies with large offerings of securities, underwriting

commissions are a cost factor that cannot be ignored in deciding the best way to finance.

71. It is recommended that commissions paid to underwriters or dealers should be deductible as an expense for income tax purposes. This would be a practical contribution to lowering slightly the threshold at which small companies can sell securities and would be helpful to all companies, thus encouraging the raising of more capital within Canada. Furthermore, it is only reasonable since these commissions are in fact an expense of doing business.

THE INDUSTRIAL DEVELOPMENT BANK

72. The Association endorses the principle and role of the Industrial Development Bank and believes that it has been very valuable in filling gaps in the financial facilities available to industry. At the same time, the Association would prefer an expansion of alternative sources of private enterprise financing and of internally generated funds to any substantial expansion of government banking. In this connection, some initial moves by large financial institutions toward programmes of investment in small business are noted with satisfaction; it is hoped that these will expand. As pointed out elsewhere in this submission, manufacturers would stand to improve their financing ability considerably with lower rates of corporation income tax and more liberal capital cost allowances.

73. The Association believes in the soundness of the Industrial Development Bank not providing capital where it would be available on reasonable terms from

private enterprise sources and trusts that this principle will continue to be followed.

74. A number of members of the Association have complained about the length of time taken in securing funds from the Industrial Development Bank and the costs attending such transactions. It is understood that the Bank does endeavour to reduce the waiting period for loans, but it would be appreciated if the Commission would study this in order to arrive at an assessment of the reasonableness of these delays. The Commission might usefully have experts examine whether the costs to borrowers of arranging loans from the Bank could be reduced.

75. A number of suggestions by members of the Association regarding the policies of the Industrial Development Bank are brought to the Commission's attention. The Association has not undertaken to pass upon the merit of these views, which would require the type of study which the Commission is probably better situated to give them. These suggestions, which are not necessarily consistent with each other, coming as they do from various sources, are as follows:

(a) that loans for longer periods are required;

(b) that excessive security is required, making other financing elsewhere difficult;

(c) that initial repayments on new loans should be delayed;

(d) that loans should be made for more venturesome purposes, with more attention

to the potential of the business;

(e) that care, or more care, should be taken not to cause uneconomic expansion of particular industries;

(f) that loans should be made for purposes for which it is asserted they are not made, or not often made, now, such as the acquisition by employees of a U.S. subsidiary, for short-term financing or working capital purposes, to consolidate existing debt, to aid the marketing of machinery made by a manufacturer by providing funds to finance leasing to customers and for the acquisition of a poorly managed bankrupt business for expansion purposes;

(g) that application requirements are too complicated, involving the provision of too much information;

(h) that smaller loans should be available;

(i) that penalties for early repayment are too high;

(j) that the Bank's policies should be specially geared to import replacement.

76. Some of the above suggestions are expanded in Appendix IV.

INVESTMENT POWERS OF LIFE INSURANCE AND TRUST COMPANIES

77. Life insurance companies should be encouraged to invest more funds in Canadian industry. With this

in view, a study should be made of the basis of valuation of common stocks in life insurance company portfolios and of the necessity for the present level of the limitation on common stock investments.

78. Similarly, study should be given to the advisability of liberalizing provincial legislation in various jurisdictions governing the investment policies of trust companies. (It is noted that the trustee law of Nova Scotia is cited by trust companies as a model in this regard).

PENSION PLANS

79. Industry has for many years recognized the desirability of providing as far as possible for its employees' retirement income, and pension plans now cover about 75 per cent of the employees of Canadian manufacturers. However, pension plans are not only a channel through which benefits are provided and funds invested in various uses,. they are also a part of the cost of goods and the effects on costs, prices and profits of pension benefits cannot be ignored.

80. It is most disturbing to hear proposals that government should duplicate the pension plans of industry by imposing a "second tier" retirement plan. Canadian manufactured goods can bear reasonable pension costs but any pyramiding of expenses will be distinctly harmful. There is no point in providing an extra pension plan for an employee who may not be able to continue to earn a living during his working years because the products he is engaged in producing have been priced out of the domestic or international market;

nor should working people and their employers be expected to transfer so much of their income by taxes or contributions as to leave them worse off than the recipients of retirement benefits. In addition, the investment of funds is something which sould be tailored to the needs and preferences existing in individual industries and companies. It is vitally important that investment policies should be conducted on the basis of investment principles rooted in the market place rather than being tied by statutory or other artificial rules. In any case, to deliver over to government the task of investing or superintending the investing of retirement funds is to deliver over to bureaucracy the investment of a large and growing section of the nation's resources. This is as unnecessary as it would be unwise.

81. One of the problems facing the economy is that pension funds, of which industry is a major source, are diverting increased amounts of money to uses outside industry. With the increase in recent years of employee contributions to pension plans and tax payments to old age security schemes, it is reasonable to assume that the covered individuals have reduced other forms of savings, substituting their equity in pension plans for saving accounts, ownership of securities or other long-term savings programs. This has tended to make less money available to industry than would have otherwise been the case.

82. The great increases in corporate pension accumulations in the past ten years, much of which represents a substitution rather than new savings, have

come into the capital markets under the administration of trustees having different objectives and restrictions than those of banks and insurance companies. This has changed the availability of funds for many users of capital.

83. Some statistical information on the effects of restrictions on the investment of pension funds is given in Appendix V.

84. Unless a substantial portion of pension funds is available for the financing of business and industry, the growth and vigour of pension plans must inevitably decline since business and industry are the source of most pension plans. It is noteworthy that most trusteed pension plans of educational institutions, governmental and other official and quasi-official bodies invest in scarcely anything at all except the obligations of government and public organizations. Since conservatively managed pension funds in private industry find it possible to invest in the securities of private enterprise, public authorities should do likewise and not pre-commit all their funds to the public sector. The participant whose funds are involved by virtue of contributions is entitled to the most favourable interest return consistent with the normal requirements of safety.

85. The Canadian Manufacturers' Association is acutely aware of the necessity of safeguarding the contributions of their employees and of the funds from which they must receive their retirement income. However, industry should remain free to operate its own pension plans and as many pension plans as possible should be

free to invest in industry. The successful achievement of the full benefits of a pension plan must ultimately depend on the successful operation of the employer.

BANKRUPTCY

86. To indicate the extent to which manufacturers supply financing to their customers, it might be pointed out that the balance sheets of all manufacturing corporations tabulated by the federal tax authorities for 1959 taxation year show total receivables of $2.7 billion. This compares with $3.8 billion owed to banks by corporations in all industries, in the same statistics. It is interesting to note that retailing corporations had payables 88 per cent greater than their bank debts.

87. It is obvious that trade credit plays an important role in the over-all financing picture in Canada. It is, therefore, vital that laws affecting trade credit operate in an equitable fashion, so as not to throw up unnecessary barriers to its free flow.

88. When bankruptcies occur among their customers, there is a cost to manufacturers. There is also sometimes serious danger to the survival of small manufacturers who must grant credit as a means of competing, but who are particularly vulnerable to credit losses, which may in individual cases assume large proportions relative to their own assets. One manufacturer has stated to the Association that his biggest single financing problem is credit risks.

89. The Association recommends that there be an adequately staffed enforcement body policing the Bankruptcy Act to seek out and prosecute fraudulent

bankrupts. These have become a problem and it is often difficult or impossible for manufacturers to investigate and prosecute such cases themselves. Effective policing would discourage dishonesty by a minority of debtors and reduce abnormal credit risks.

FOREIGN EXCHANGE

90. The Association circulated a questionnaire among its members just before the "pegging" of the dollar in May, asking for opinions on the effects of earlier depreciation in the foreign exchange value of the dollar. The results of this survey are presented in Appendix VI to this submission, with answers postmarked before the change to a fixed rate separated from other returns.

EXPORT CREDITS INSURANCE AND FINANCING

91. The financing of export sales presents special problems because the time lag between shipment of goods and receipt of payment is much greater than in domestic trade. This is a result not only of transportation factors, but, particularly in the case of capital goods, of a tendency on the part of many countries to woo foreign buyers by offering more and more favourable credit terms. The problem is intensified because there are risks involved which are not as clearly predictable as those in domestic business.

92. The Government and the chartered banks have done much to overcome these problems. The provision of export credits insurance and guarantees through the Export Credits Insurance Corporation improves the quality of short and medium-term receivables as security for bank financing; the Export Finance Corporation of

Canada Limited is ready to re-discount medium-term export paper (one to five years); and the Government now provides direct financing of long-term export sales (over five years) under Section 21A of the Export Credits Insurance Act.

93. It is important that these facilities, commendable as they are, operate in such a way as to provide the most liberal coverage possible and at the lowest possible rates of premium.

94. It is suggested that the Export Credits Insurance Corporation should be as liberal as possible in its determination of the borderline between goods which are eligible for medium-term coverage and those which are not.

95. It is recommended that consideration be given by the Export Credits Insurance Corporation to increasing the percentage of risk which it will cover in appropriate cases involving medium-term credits where exporters find difficulty in financing the portion for which they are at risk under the co-insurance principle. The present Canadian limit is 85 per cent, but export credits insurers in some other countries are prepared to cover as much as 95 per cent.

96. It is suggested that further study should be given to the need for re-discount facilities for insured short-term export paper where recourse would be limited to the exporter's 15 per cent share under the co-insurance principle.

97. In order to obtain a broad spread of risk, the Export Credits Insurance Corporation requires that an

exporter covered by a general commodities policy (short-term credits) must, as a general rule, insure all his exports, with certain specific exclusions. It is suggested that this aspect of its policies should be reviewed by the Corporation with a view to devising means of relieving exporters of the cost of insurance premiums on that portion of their slaes which they believe it unnecessary to cover.

98. Particular consideration should be given to reducing export credits insurance premiums on medium-term credits for major capital goods contracts, where the amounts involved are quite large and where even a fractional percentage reduction from the average of 3 per cent would result in significant savings to the exporter.

99. It is recommended that the Government should follow the practice of most other countries by providing that the Export Credits Insurance Corporation be exempt from income tax. (While the Corporation's gross premium income in 1961 was $744,000, its income tax for that year was $740,000). This would permit the entire excess of premium income over operating expenses and net claims paid to be applied to a substantial reduction of premium rates, while net income from investments could be used to reinforce the Corporation's underwriting reserve.

100. With regard to long-term financing procedures, the present system calling for the issue of promissory notes by the foreign buyer to the Canadian exporter, the guarantee of the notes by Export Credits Insurance

Corporation and then their subsequent sale by the exporter appears to be somewhat cumbersome. The Association suggests that the provisions of Section 21A of the Export Credits Insurance Act be re-drafted so that the procedure is simplified.

101. Because of the complexity and special timeliness of this subject and in order to provide the Commission with more background information, these suggestions and recommendations are elaborated in Appendix VII.

SUMMARY OF RECOMMENDATIONS

102. The following is a summary of the recommendations embodied in the submission:

Recommendation No. 1 Monetary and fiscal policy should have as their objectives -- in so far as either instrument is applicable to these ends -- economic growth, economic stability, the avoidance of price inflation, the maintenance of a suitable foreign exchange rate and the minimizing of unemployment.

Recommendation No. 2 Fiscal policy should be closely co-ordinated with monetary policy to avoid unnecessary competition with private enterprise for funds. It is unsuitable for government to expand its spending and borrowing while the monetary authorities are calling upon business to restrain its expansion and implementing this imperative through a tightening of credit.

Recommendation No. 3 Government expenditures intended to stimulate the economy during periods of slackness should be used with care lest they tend to produce avoidable inflation or introduce programmes that may prove difficult to eliminate or reduce when their stimulating effect is no longer required.

Recommendation No. 4 Income taxes are at too high a level for either the short-term or long-term development of the Canadian economy. It is recommended that these taxes should be substantially reduced as a means of stimulating an overdue expansion of the economy, which in turn would increase the tax base.

Recommendation No. 5 In order to make Canadian industry

more competitive with that of European countries in terms of tax burden:

(a) corporation income tax rates should be lowered (a measure already recommended for its purely domestic effects),

(b) capital cost allowances should be expanded, and

(c) investment allowances should be introduced.

Reccmmendation No. 6 The Provincial and Federal Governments should agree on a greater degree of uniformity in their sales tax legislation, the diversity of which now greatly complicates the financial operations of many manufacturers.

Recommendation No. 7 In recognition of the fact that the assistance of foreign capital in the further development of our country will probably be a factor of great importance in the future as it has been in the past, government should order the nation's affairs so as to attract and hold the necessary foreign capital.

Recommendation No. 8 The chartered banks should be permitted to lend on the security of mortgages on any equipment, machinery or real estate used by industry. The banks now lend on residential mortgages insured by a government agency and, also under government guarantee, for some purposes that could otherwise be covered by industrial mortgages. If it is thought desirable that banks should lend for purposes for which they would feel a government guarantee was necessary, they should be

free to make loans for similar purposes in any circumstances where the risk would appear to them to justify a loan without a government guarantee, but with appropriate security. A maximum interest rate high enough to compensate for the illiquidity of such loans should be permitted.

Recommendation No. 9 A "basket clause" similar to that in federal insurance company legislation should be introduced into the Bank Act permitting chartered banks to place a specified maximum percentage of their assets in any investment of their choosing. This would leave leeway for gradual changes in the practices of the banks and for experimentation in banking practices.

Recommendation No. 10 The Association endorses the principle of banks which operate on a nation-wide scale decentralizing their operations as far as practicable to keep decision-making above the local branch level as close as possible to the needs and opportunities of the different regions of Canada.

Recommendation No. 11 The Commission should study factoring and accounts receivable financing to determine whether there has actually been a large growth of firms specializing in this type of credit and, if so, whether such a trend is a symptom of an inadequate supply of bank credit for small businesses or whether it should be regarded primarily as a beneficial broadening of credit facilities.

Recommendation No. 12 The various jurisdictions in Canada should finally achieve uniformity in their securities and companies legislation to lower the costs

of public financing and increase its feasibility for some companies not now able to use this method of raising capital.

Recommendation No. 13 Commission paid to underwriters or dealers in connection with the raising of capital should be deductible as an expense for income tax purposes. This would be of benefit to all companies offering securities, thus encouraging the raising of more capital within Canada, and would also increase the feasibility of public offerings for some companies not now able to make them.

Recommendation No. 14 The Association endorses the principle and role of the Industrial Development Bank. However, the Commission might assess the reasonableness of delays in handling loan applications and of the costs of arranging loans from the Bank, the subject of complaints from a number of manufacturers. A number of other specific suggestions or complaints about the Bank's policies or service are brought to the Commission's attention.

Recommendation No. 15 Life insurance companies should be encouraged to invest more funds in Canadian industry. With this in view, a study should be made of the limitations presently imposed upon them by the basis of valuation of common stocks in their portfolios and of the current level of the limitation on their holdings of equities. Similarly, legislation governing the investment policies of trust companies should be studied with the possibility of liberalization in mind.

Recommendation No. 16 There should be an adequately

staffed enforcement body policing the Bankruptcy Act to seek out and prosecute fraudulent bankrupts. Effective policing would discourage dishonesty by a minority of debtors and reduce abnormal credit risks.

Recommendation No. 17 Canada should avoid adding a "second tier" retirement plan to existing private pension plans as such an additional, government-operated plan would increase costs in industry, thus undermining the competitiveness of Canadian products, and divert large amounts of funds for investment by the bureaucracy rather than on the basis of market principles. One of the problems facing the economy is that pension funds, of which industry is a major source, are diverting increased amounts of money to uses outside industry.

Recommendation No. 18 Since the provision of export credits insurance has a direct bearing on the availability of financing for export sales on medium-term credits, the Export Credits Insurance Corporation should be as liberal as possible in its definition of capital goods and should consider increasing its coverage beyond the present 85 per cent of the amount at risk.

Recommendation No. 19 It is suggested that further study should be given to the need for re-discount facilities for insured short-term export paper where recourse would be limited to the exporter's 15 per cent share under the co-insurance principle.

Recommendation No. 20 Export credits insurance premiums are a significant item in the cost of doing export business and should be reduced as much as possible. Specifically,

(a) some means should be devised under general commodities policies to relieve exporters of paying premiums on that portion of their sales which they believe it unnecessary to cover,

(b) particular consideration should be given to reducing premiums on medium-term credits for major capital goods contracts, and

(c) the Export Credits Insurance Corporation should be exempt from income tax, in order that the entire excess of premium income over operating expenses and net claims paid may be used to reduce premium rates and that net earnings from investments may be used to reinforce the Corporation's underwriting reserve.

Recommendation No. 21 With regard to long-term export financing procedures, the present system calling for the issue of promissory notes by the foreign buyer to the Canadian exporter, the guarantee of the notes by Export Credits Insurance Corporation and then their subsequent sale by the exporter appears to be somewhat cumbersome. The Association suggests that the provisions of Section 21A of the Export Credits Insurance Act be re-drafted so that the procedure is simplified.

Appendix I

GOVERNMENT POLICIES AND INDUSTRIAL EXPANSION

103. Capital cost allowances have a greater direct influence than interest rate fluctuations or "tight money" conditions on the investment decisions of a great many manufacturers. That is a conclusion pointed to by the results of a questionnaire survey of Association members.

104. Manufacturers were asked this question: "Which of the following general economic conditions in the country have most influenced your decisions to undertake capital expenditures during the port-war period? (Please rank in order of importance, i.e., 1, 2, 3, or do not mark if not important). Fluctuations of interest rates; the 'tight money' situation during certain periods; depreciation rates permitted under the Income Tax Act."

105. While many wrote in comments to the effect that the possibility of marketing products at a profit was the main consideration affecting them in investment decisions, one out of four respondents to the questionnaire reported that capital cost allowances or depreciation influenced them. That is, they gave this factor a first, second or third ranking in the above question. One out of five respondents gave capital cost allowances first ranking and many of these marked neither of the other two factors, i.e., fluctuations in interest rates and "tight money" conditions. The results of this question are summarized in Table I of Appendix XII.

106. Of course, this does not necessarily mean that

interest rates and tight money do not influence these manufacturers' investment decisions indirectly, through their influence on the demand for their products; these indirect effects would naturally be difficult or impossible to identify. But these answers do lend support to the view that liberalization of capital cost allowances is a tool which government can effectively use to increase investment in the economy.

107. Another question in the survey asked manufacturers whether a tax write-off of depreciable assets in half the time presently permitted would have increased the firm's capital expenditure in the last ten years. Manufacturers were requested to indicate whether the increase would have been substantial or moderate, in their opinion.

108. The results, which are summarized in Table 2, also point to the importance of capital cost allowances as a factor affecting investment decisions in industry.

109. About one-third of all respondents to the questionnaire said that a faster write-off would have increased their capital investment programmes moderately. Almost one in every ten firms returning a questionnaire form said it would have increased their programme substantially. Thus, some 42.5 per cent of all respondents reported that a faster write-off would have increased their capital expenditures in some degree.

Appendix II

TAXATION, CAPITAL COST ALLOWANCES AND INVESTMENT ALLOWANCES

TAXATION RATES

110. It is not easy to compare the taxation rates in effect in the various industrial countries since there are many variables in their application. The most meaningful comparison is obtained when the corporate rates of tax of each country are applied to a given factual situation. In an article by Jacques Barbeau, entitled "Corporate Income Tax Burden in Europe", published in the July-August, 1961 issue of "Canadian Tax Journal", pages 297-306, there is the following table setting out the proportion of direct taxes as a percent of taxable income under circumstances where a corporation has a net worth of $3,750,000 and a net profit of $375,000.

	40% Distribution	100% Distribution	No distribution of Profits
Blegium	25%	21%	27%
France	50%	50%	50%
Germany	65%	53%	70%
Italy	41%	41%	41%
Netherlands	47%	47%	47%
Sweden	48%	48%	48%
United Kingdom	42%	25%	54%
Average rate:	45%	40%	48%
Canadian rate:	48%	48%	48%

CAPITAL COST ALLOWANCES

111. In addition to the ordinary capital cost allowances based on the life of the particular asset, most European countries grant initial or accelerated depreciation allowances and some form of investment allowances. The main difference between initial allowances and investment allowance is that initial allowances reduce the depreciable cost of the capital asset, but investment allowances do not have this effect, being in addition to both normal depreciation and initial allowances. Barbeau, in the above-mentioned article (page 301), states that initial or accelerated depreciation allowances, are granted in addition to normal depreciation in all European countries, except Belgium and Sweden. Initial depreciation allowances are normally granted only in the year the depreciable asset is acquired. As instances of the operation of initial depreciation the practice in the Netherdlands and the United Kingdom may be outlined.

112. In the Netherlands an initial allowance of 33 1/3 per cent spread over two years is granted on all assets acquired or improved for business purposes (an exception to the one-year rule just noted).

113. In the United Kingdom the normal rates of depreciation are multiplied by five-fourths in computing the annual amount of depreciation which can be claimed for tax purposes. ~~In~~ addition, an initial depreciation allowance is granted on certain capital expenditures at the following rates: 15 per cent on industrial buildings, and 30 per cent on new machinery and plant

(The Federation of British Industries, "Taxation in Western Europe, 1961", page 172).

114. In Austria accelerated depreciation is allowed at the rate of 20 per cent in respect to expenditure on real property and 40 per cent on movable capital assets.

115. Accelerated depreciation may be granted in Belgium under special circumstances at the rate of one-third of the cost price of fixed assets.

116. There is provision in Italy for accelerated depreciation on new plants constructed since January 1st, 1946, under which the period of normal depreciation is reduced by up to two-fifths.

117. Ireland grants accelerated depreciation of 10 per cent on capital expenditure for new industrial buildings. On new plant and machinery the rate is 25 per cent.

INVESTMENT ALLOWANCES

118. In most European countries, with the exception of France and Germany, in addition to normal and initial depreciation allowances, there are what are known as investment allowances. In some cases the deduction is computed on the basis of the cost of the asset, while in others the deduction is computed on the basis of taxable income. Investment depreciation allowances which are based on the cost of the asset are granted in both the Netherlands and the United Kingdom.

119. In the Netherlands the investment depreciation allowance is generally at the rate of 10 per cent, but for ships and airplanes it amounts to 16 per cent. It is spread over two years and is applicable to all capital

assets. The effect of this is that either 5 per cent or 8 per cent of the cost of an asset can be deducted for a period of two years without reducing the amount of normal and initial depreciation which may be deducted. (The International Bureau for Fiscal Documentation, Amsterdam, "European Taxation", Vol. 1, No. 6, page 8).

120. In the United Kingdom the investment depreciation allowances and the initial depreciation allowances are interrelated so that the rates of initial depreciation are reduced if both an investment allowance and initial depreciation are claimed on a particular asset. On industrial buildings a company may claim 10 per cent investment depreciation plus 5 per cent initial depreciation. On new machinery and plant 20 per cent investment depreciation is allowed plus 10 per cent initial allowance (Barbeau, page 302).

121. Other types of investment allowances which resemble income tax exemptions more than depreciation deductions are granted in Italy and Sweden. The best known is that of Sweden under which corporations are permitted to set aside as a deductible investment reserve up to 40 per cent of their pre-taxable income.

Appendix III

THE CHARTERED BANKS

122. One section of the questionnaire sent by the Association to its members dealt with their experience with the chartered banks. The principal matters which the questionnaire sought to investigate in this area were the extent to which manufacturers have been affected by recent periods of restricted credit, the extent of use

of term loans, the demand among manufacturers for increased term loan facilities and opinions on the Small Businesses Loans Act. There was also an interest in the practice of some bankers in requiring "cash collateral" for loans and the extent and effects of this policy.

123. Respondents were asked, "Did your firm have difficulty in obtaining desired bank credit in 1956 or 1959?" Replies are summarized in Table 3 of Appendix XII.

124. Some salient conclusions which can be stated are:

(a) The highest percentage of tabulated returns reporting difficulty in getting bank credit in 1956 or 1959 is found in the smallest size-class of private companies controlled in Canada, Some 32% of of these returns reported such difficulty, compared with 13.8 per cent of all returns of all types and sizes of firms.

(b) Difficulty with bank credit in 1956 or 1959 was almost exclusively a problem of Canadian-controlled firms among the respondents. Out of 168 tabulated private and public companies controlled outside of Canada, only two, or 1.2 per cent, reported having had difficulty. Out of 371 private and public companies controlled in Canada, 19.1 per cent reported such difficulty.

(c) Among respondents, public companies controlled in Canada had less difficulty than private companies controlled in Canada. Of 52 public companies controlled in Canada having sales of more than $1 million a year, only four, or 7.7 per cent, reported difficulty getting desired bank credit. In the same size-classes, 16.9 per cent of 124 private companies controlled in Canada reported having had difficulty.

125. The extent to which different classes of firms usually rely upon bank credit may, of course, vary and ideally the preceding comparisons should take this into account. It is suggested, however, that some of the contrasts in the answers from different groups are so marked that it seems likely that they represent real differences in the incidence of credit restriction. So far as the effect of non-response to the question and to the questionnaire is concerned, there seems to be no obvious reason why the rate of non-response among firms which had difficulty with bank credit should be expected to be greater or less in one group or size-class of firms than in another.

126. Manufacturers were also asked, "Have you ever attempted to obtain a term loan from a chartered bank, that is, a loan of more than one year original maturity or funds furnished through the direct sale to a bank of a firm's own corporate bonds or debentures of more than one year's maturity? (Do not include loans under the

Small Businesses Loans Act.)" Replies to this question are summarized in Table 4.

127. Two conclusions are evident:

(a) The reported use of term loans rises with the size of firm in the case of private companies, whether controlled in Canada or elsewhere. Because these companies make up such a large percentage of the replies reporting the use of term loans, this is also true of the totals for all types of companies. In the case of public companies it is difficult to establish a definite relation between the size of the respondent firm and the use of term loans, on the evidence available.

(b) The greatest part of the respondents have never sought a term loan and so report. However, in view of the replies to a further question about the desire for term loans and the fact that it is well known that the chartered banks' willingness to make these loans is rather limited, this should not, it is submitted, be interpreted as indicating a lack of demand for such loans.

(c) The ratio of those reporting having been unsuccessful in seeking a term loan to those reporting having

been successful is highest for small private companies controlled in Canada. A tabulation for private companies controlled in Canada, removing comparisons with other types of companies, is given below. It shows that, among the respondent firms, there was a relation between size of firm and the degree of success in getting term loans (although the number of firms in the top size-class is very small).

Experience in Seeking Term Loans,
Private Companies Controlled in Canada.

Sales Class of Respondent	Respondents in Size-Class Who Report Applying for Term Loan	Proportion of Reporting Applicants in Size-Class Who Were Unsuccessful.
Under $250,000	16.9%	45.5%
Over $250,000 Under $1 million	14.5%	27.8%
Over $1 million Under $10 million	17.4%	10.0%
$10 Million or Over	33.3%	Nil
All Sales Classes	16.6%	23.1%

128. A further question on term loans was asked, "Would you wish to obtain a term loan (other than a loan under the Small Businesses Loans Act) if such loans were more widely available?" The results of this question are summarized in Table 5. One-quarter of all tabulated returns have a "Yes" answer to this question. The

percentage of "Yes" answers is highest among respondents which are private companies controlled in Canada. There is no clear-cut relation between the answer to this question and the size of the respondent; however, the smallest size-class of private companies controlled in Canada has a higher proportion of "Yes" answers -- 43.1 per cent -- than other group. Answers for the different classes of companies may be analyzed as follows:

Percentage of Tabulated Returns Reporting Wish for Term Loans, by Type of Ownership.

Private Companies	
Controlled in Canada	36.1%
Controlled outside Canada	7.2%
Public Companies	
Controlled in Canada	15.5%
Controlled outside Canada	13.9%
Other	22.2%
All types of companies	25.3%

129. Members of the Association were also asked, "Based on your own firm's experience with the Small Businesses Loans Act, please give any suggestions on how lending operations of chartered banks under the Act could be made more satisfactory to you or how the Act itself might be improved?" These were the suggestions most frequently made:

(a) that longer-term loans should be available than are now offered and that types of loans not made now under the Act should be provided for;

(b) that the Act should apply to larger

businesses than at present. The results of some of the other questions, tabulated according to size of sales, may be of some assistance to the Commission in assessing the merits of this claim (See Tables 3, 5, 9 and 10 of Appendix XII.

130. Because the practice of some Canadian bankers of requiring some borrowers to provide "cash collateral" affects the cost of credit and because there has been little public discussion of this practice and its significance, the Association's questionnaire asked the following questions, "Does the bank ever require you to keep a minimum percentage of your loan, or a certain sum, on deposit as a condition of making you a loan? Has the bank ever raised this requirement during periods of scarce credit?" Answers to these questions are summarized in Tables 6 and 7 of Appendix XII.

131. Respondents were also asked the percentage of outstanding loans they were required to keep on deposit. Further questions asked the nominal interest rate currently paid at the bank and "the effective rate of interest you currently pay on bank credit, taking into account any minimum balance of 'cash collateral' requirements and any deduction of interest before advancing the principal and any other considerations?"

132. The facts disclosed by the answers are:

(a) The practice of requiring a minimum percentage of a loan, or a certain sum, to be kept on deposit as a condition

of making a loan is limited in scope, only 31 respondents, or 5.6 per cent of all tabulated returns, reporting it. Less than half of these reported that the banks raised these requirements during periods of scarce credit.

(b) Whereas only somewhat more than half of all tabulated returns were from private companies controlled in Canada, these companies account for three-quarters of the reports of such requirements being made.

(c) The reported numbers of cases of these requirements are small in all size-classes, but, whether by chance or for fundamental, underlying reasons, they account for a nearly constant percentage -- from 7 per cent - 9 per cent -- of all tabulated returns in the bottom three size-classes of private companies controlled in Canada. The pattern of a larger incidence of unfavourable experience in the smallest size-class of respondent, as was found with the ratio of unsuccessful applicants for term loans and difficulty with bank credit during periods of restricted credit, is not apparent here.

(d) However, it is not possible to say with confidence that all the reported

instances of requirements to keep balances of particular size are actually "cash collateral" requirements, that is, the equivalent of the American banking practice of requiring compensating balances. Some of the details reported in respondents' comments on their answers to this question would appear to relate to other banking practices. Furthermore, it appears to be possible that respondents have figured the percentages of their loans which must be kept on deposit on different bases and that some misunderstood the question on the effective interest rate; accordingly, no tabulations have been prepared on the last two topics.

133. It appears that "cash collateral" requirements are sometimes the subject of bargaining, in as much as respondents report having successfully refused requests for such compensating balances, one securing instead an overdraft, with interest paid on the net overdraft.

134. It may be worth noting that some respondents of whom the banks do not make "cash collateral" requirements report paying bank interest rates above 6 per cent.

135. A complaint voiced by manufacturers answering the questionnaire is that bank loans on a demand basis are often unsuited to the needs of manufacturing. One

respondent put it this way: "Had a bad experience with a chartered bank about 1952. Biggest complaint with chartered banks is their demand loans for one-year term. You can't properly plan a manufacturing operation only one year ahead. Two years would be better, five years better still". Another comment: "The bank is all right up to slightly less than one year. But too dangerous for longer periods". Still another says "Short-term loans, the only ever available to us, are unsuitable for expansion or development....Had long-term loans been available, we would have a larger industry today." Another suggests: "Six to twelve months notice of 'call' for all loans would permit manoeuvering"; he is presumably thinking of loans to manufacturers. Still another comment: "The main problems which we have encountered in the past in our dealings with the banks has been the tendency for the bank to operate on a shorter cycle than our requirements. While our short-term financial forecast must be at least six months ahead because of our manufacturing cycle, the bank seems reluctant to commit themselves beyond three months. This tendency was apparent prior to 1959 but is not so now." These are just a sampling of similar opinions expressed to the Association.

Appendix IV

THE INDUSTRIAL DEVELOPMENT BANK

136. All members of the Association were asked the following question: "Based on your own firm's experience with the Industrial Development Bank, please give any suggestions on how the service or policies of the

Industrial Development Bank could be improved."

137. A large number of comments were received, both favourable to the Bank and of a more critical character. The former type of comment consisted chiefly of testimonials to the assistance which the Bank had been to individual firms; the latter type were more numerous, but constituted repetitions of certain specific criticisms or suggestions in many cases.

138. Some of the suggestions and criticisms brought to the Commission's attention in the main body of the submission might perhaps be listed again here with some expansion where that is possible. These comments or criticism were:

(a) That loans for a longer period are required. Some respondents thought that terms of 10 years, 15 years or 20 years should apply in circumstances in which they had found the Bank willing to lend only for shorter periods. "Ten years is too short on purchase of plant buildings and land", one respondent commented.

(b) That excessive security is required, making other financing elsewhere difficult. As one manufacturer put it: "The Industrial Development Bank insists on too much security and this limits the interest of shareholders in purchasing more shares and limits somewhat other banks as to their interest." Another

suggested the Bank could improve its service by "not attempting to tie up every nut and bolt in the place as security; in the event additional funds are required there would still be some security left as collateral". The creditor's view of the same alleged policy of the Bank was expressed by a manufacturer who said: "We take a close look at customers who have I.D.B. loans; I.D.B. ties up the customer's assets so tightly that, in case of bankruptcy, we stand a poor chance of recovery as we are an unsecured creditor." Another respondent said: "The practice of requiring chattel mortgages in excess of the value of the loan is, we feel, completely unnecessary." Others were critical of the practice of requiring personal guarantees from directors of a company. Related to criticisms of security requirements were complaints about excessive restrictions on the management of a company having an outstanding loan. One respondent said the Bank could improve its service by "not restricting a company too severely once a loan is made. This could be done by working more closely with the company on

completion of loans." (This company noted, however, that its relations with the Bank had always been very cordial).

(c) That initial repayments on new loans should be delayed. One respondent suggested there should be no principal repayment during the first one or two years of a loan. Another said that "repayment of I.D.B. loans commencing almost immediately after receipt does in fact consume the profits from the expanded operation. When this situation exists for a period of years, little benefit in increased capital from profits occurs. I.D.B. loans with postponed repayment of principal would be useful."

(d) That loans should be made for more venturesome purposes, with more attention paid to the potential of the business. Some expressions of opinion to this effect are as follows: "The I.D.B. should be permitted to carry a percentage of its profit in 'risk capital' financing. The policy should accept the likelihood of substantial losses from a percentage of such financing which would be more than recouped from successful ventures."

"Investigators were interested only in present company earnings."

"Provide a less restrictive nature to policies of I.D.B. to allow more risk capital secured only by the qualifications and abilities of management and small business and optimistic outlook on the possibilities of growth potential."

(e) That care, or more care, should be taken not to cause uneconomic expansion of particular industries. One expression of this viewpoint was as follows: "We have been greatly assisted by the officers of the I.D.B. and their financial investment has helped tremendously in our expansion. We note that this assistance sometimes reacts unfavourably when their assistance leads to over-production in a certain industry and in a certain area. More attention could be given to this economic issue." It might be noted that another respondent believed that small business could through the Industrial Development Bank get funds for expansion purposes "on terms and at costs which are not available to large businesses."

(f) That loans should be made for

purposes for which a respondent asserted they are not made, or not often made, now, such as the acquisition by employees of a U.S. subsidiary, for short-term financing or working capital purposes, to consolidate existing debt, to aid the marketing of machinery made by a manufacturer by providing funds to finance leasing to customers and for the acquisition of a poorly managed business for expansion purposes.

Appendix V

PENSION PLANS

139. In the year 1960 contributions to pension plans, as reported by the Dominion Bureau of Statistics ("Trusteed Pension Plans, 1960", page 9), were as follows:

Trusteed Pension Plans	$393 million
Insured Plans: Life Insurance Companies Group Annuities Only	146 million
Canadian Government Annuities: Group Annuities Only	30 million

The assets in these plans in millions of dollars were, respectively: 3,616; 1,208 and 600. With the restrictions on investments imposed by Canadian and British Insurance Companies Act, it is obvious that a large part of the contributions and the assets are not available for investment in industry.

140. While the assets in pension trusts, totalling

$3,616 million in 1960, are not now restricted to exclude investment in industry and under most trust agreements the trustee has freedom of action within the investment powers provided, most investment portfolios reflect the restrictions imposed from 1950 to 1957 by federal legislation. A breakdown compiled by a consulting actuary of pooled funds maintained by three trust companies for pension fund investment reveals the following distribution:

Obligations of Government in (Canada, Provincials, Municipals) and Their Guarantees	39%
Corporation Bonds	35%
Mortgages	6%
Common Shares	17%
Other	3%

141. The assets of $1,208 million in insured pension plans are restricted to 15 per cent investment in equities except for segregated plans.

142. None of the assets of Government Annuities contracts, totalling $600 million in 1960, are invested in Canadian business and industry.

Appendix VI

FOREIGN EXCHANGE

143. In the questionnaire which the Association sent to all its members seeking background information for use in the preparation of its submission, questions were included on the experience of manufacturers with fluctuations in the foreign exchange rate. While these questionnaires were being filled out, the Government announced the adoption of a fixed rate of exchange and a

further devaluation.

144. The practical importance of the answers was greatly reduced by this change, and the Association decided no recommendations on the subject were called for. But as some of the answers may be of interest or value to the Commission, they are summarized in Table 8.

145. Returns postmarked May 2nd or earlier were separated from the others for purposes of tabulation. (The new foreign exchange rate policy was announced on the evening of May 2nd.). However, a study of the two sets of results would seem to indicate that this occurrence during the filing of the returns made very little, if any, difference to the replies. The percentage of all those returning questionnaires who answered the questions on foreign exchange was higher for every question among those respondents mailing returns on May 3rd or later, but the difference was substantial only in the case of a question asking about the effects on export sales.

146. The percentage of firms stating whether or not they buty or sell foreign currencies for use in their businesses to any appreciable extent was almost the same for the two groups. (About one-third of all those filing returns, and almost the same proportion of those answering the question, state that they do buy or sell foreign exchange to an appreciable extent).

147. One conclusion which emerges clearly is that a large number of the respondents approve of the principle of a fixed foreign exchange rate. Some 43 per cent of those mailing returns before May 3rd said they would like

to see a "pegged" exchange rate; about 49 per cent of those mailing returns later answered similarly. (In this instance, it is conceivable that the announcement of the fixing of the rate influenced the answers and raised the percentage of those reporting approval of fixed exchange rates).

148. Most of those who did not answer "Yes" to register approval of fixed exchange rates, chose to mark an alternative reply, "Have no strong opinion", rather than answering "No" to register disapproval of fixed exchange rates. In all, about 11.8 per cent of those answering the question said they did not like a fixed exchange rate, as compared with 36.7 per cent who said they had no strong opinion and 51.6 per cent who approved of a fixed exchange rate. However, less than a majority of all those filing returns answered "Yes" to this question.

149. Members of the Association were also asked about their experience with the depreciation of the Canadian dollar (that is, the depreciation preceding the May, 1962 devaluation). The replies may be analyzed as follows:

Effects of Exchange Depreciation

	-----Percentage of-----	
	All Returns	All Respondents Answering Question
Depreciation increased export sales	11.8%	21.2%
Depreciation increased domestic sales because of higher prices for imports competing with respondent's products	16.9%	20.8%
Depreciation increased costs because of higher prices for imported materials or parts	76.5%	86.2%
Depreciation caused respondent to make, or contemplate making, new products in Canada which because of competition would not have been possible before	15.3%	17.0%

150. The number reporting an increase in export sales should be compared with the number of firms engaged in exporting. Since firms were asked to answer only if they export, the 21.2 per cent of those answering the question would seem to apply for this purpose. However, a considerably smaller number of firms replied to a question in another section of the questionnaire by stating what percentage of their sales are accounted for by exports. It would seem possible that some respondents misunderstood the question on the effect on exports of exchange depreciation and reported no increase in exports when they do not in fact export. Those reporting an increase in export sales attributed to exchange depreciation are equal to 24.5 per cent of the number reporting elsewhere that some percentage of their sales

is being exported.

151. The number reporting increased domestic sales because of depreciation of the dollar amount to 26.7 per cent of those who gave a definite positive or negative answer; a number of others checked an alternative answer, "Little or no import competition".

152. Similarly, the number of firms stating that they have raised prices because of higher costs resulting from depreciation should be compared with the number reporting higher costs from this cause. The former number amounts to 39.2 per cent of the latter, with almost all the remainder stating that they have not raised prices.

153. The significance for the economy of answers to these questions would, of course, be influenced by the size of the respondent firm involved. Because of the diminished practical importance of the questions with the Government's decision on foreign exchange policy, a size breakdown was not attempted. It will be evident also that the size of the new product programmes being undertaken would be more important than either the number or size of the respondent firms planning them. Some of the 85 respondents reporting new product programmes might be undertaking quite sizeable expenditures or increases in their employment.

154. Other questions dealt with the reactions of manufacturers to fluctuations in the foreign exchange rate under the old "floating" exchange rate system. The results of these questions may be analyzed as follows:

Effects of Exchange Rate Fluctuations

	-----Percentage of-----	
	All Returns	All Respondents Answering Question
Respondents who find that fluctuations in the foreign exchange rate is ever a problem in day-to-day business operations	35.9%	39.8%
Respondents who have refrained from undertaking capital investments, or reduced them, because of foreign exchange rate fluctuations	7.2%	8.2%

155. Roughly half of those indicating that they had refrained from undertaking capital investment programmes, or had reduced them, said that they were waiting until the rate was more favourable; the other half checked the answer, "Unwilling to invest at all because of possible future instability." (The significance of the latter replies in returns mailed after May 2nd is somewhat uncertain). Again, although the absolute number of these replies on capital investment programmes is not large, the unknown size of the individual programmes would be important.

156. Of those who report that they buy or sell foreign currencies to any appreciable extent, 24.5 per cent say that they "hedge" their foreign trade or financial transaction usually or frequently. About half of these do so "usually", the other half "frequently".

Appendix VII

EXPORT CREDITS INSURANCE AND FINANCING

EXPORT CREDITS INSURANCE

157. While recognizing the clear distinction between the financing of exports and the insurance of export sales against political and credit risks, the Association believes it appropriate to make more than passing reference to the latter subject in this context. Export credits insurance is an important factor in facilitating the financing of manufacturers' export sales; indeed, in anything beyond short-term business it has become almost an essential where bank or other financing assistance is sought.

Types of Insurance Policies

158. Export Credits Insurance Corporation, a Crown Company, provides insurance to Canadian exporters of goods and services to protect them against non-payment by foreign buyers due to credit and political risks involved in foreign trade. The Corporation issues:

(a) whole turnover policies for consumer goods and general commodities which are normally sold on short credit date of shipment (this type of policy covers an exporter's entire export sales of such goods for one year), and

(b) specific policies covering capital goods or services sold on medium credit terms extending up to a maximum of five years. An individual policy is issued to cover each contract of sale.

159. In response to a questionnaire sent out by the Association, some members indicated that the distinction between capital and non-capital goods was a point on which they had had difficulty with Export Credits Insurance Corporation. This, of course, is a technical matter; it is not possible to lay down any hard and fast rules for distinguishing between the two categories and borderline cases must be individually considered. In deciding whether the goods in question can be considered as being in the "capital" category (so making them eligible for insurance coverage on a medium rather than a short-term credit basis) the Corporation advises us that they base their decisions on what the terms of trade for such goods are internationally. In this area of judgment, the Association suggests that the Export Credits Insurance Corporation should be as liberal as possible in its interpretations since export credits insurance coverage is often essential in securing the necessary financing of such export transactions.

Principle of Co-Insurance

160. The principle of co-insurance applies to all policies issued by the Corporation; in the event of a loss being incurred the Corporation pays up to a maximum of 85 per cent of the amount of any loss and the exporter bears the balance. This principle is followed because it is considered that an exporter should have a continuing interest in the collection of each account insured; in this way it is felt that a restriction is placed on the indiscriminate extension of credit.

Coverage

161. To obtain insurance coverage, an exporter must, as a general rule, insure his exports to all countries. He may, however, exclude:

(a) sales made against irrevocable letters of credit,

(b) sales to buyers in the United States of America, and

(c) sales where the foreign buyer is a subsidiary of the Canadian exporter.

162. Some members of the Association have stated that they would prefer to see arrangements under which they would not have to insure all of their exports; some of their export sales are to customers where they consider that there are no risks of loss. They feel that having to include such sales in the overall total on which insurance premiums are paid to the Corporation results in too high an insurance cost. Because of this, some companies have preferred not to insure and have assumed any risks themselves.

163. The Corporation's policy of requiring all export sales to be covered (other than the three exceptions noted above) is based on the principle that there must be a broad spread of risk and that with this the Corporation can quote rates which are moderate and competitive. The Corporation has stated that country selection can be costly and that experience has proven that there is a real risk of loss on shipments to any country in the world. At the same time the Corporation is prepared to make an exception in certain circumstances as long as the balance

of the exporter's sales to be insured provides the Corporation with a broad spread of risk. Accordingly, an exporter, who may wish to secure coverage without having to include all his export business, is not precluded from applying to the Corporation for coverage on this basis.

164. The Association appreciates the soundness of the principle of spreading insured risks as widely as possible but suggests a review by the Corporation of this aspect of its policies with a view to devising some means of relieving exporters of the cost of insurance premiums on that portion of their sales which they believe it unnecessary to cover.

Premium Rates

165. Premiums quoted to each individual exporter are based on the class or type of goods sold, the countries to which they are shipped, the credit terms, the volume of the exporters's annual sales, the spread of risk afforded to the Corporation, and the exporter's previous loss experience.

166. Export Credits Insurance Corporation has stated that it has a continuing policy of reducing premium rates progressively, that its aim is to provide insurance on a cost basis and that the Corporation is not out to make a profit; in other words, its objective is to change premiums at rates which, in the long run, will meet its operating expenses and the net claims which it has to pay. Since the Corporation's inception in 1945, the average premium charged on short-term credit risks underwritten has been less than two-thirds of 1 per cent, while in the case of medium-term credits the average premium has been

3 per cent. For all risks, as a whole, the average premium has been one per cent.

167. Several members of the Association have stated that they feel that the insurance premiums charged are too high. It is, of course, only prudent that the Corporation's rates should be set at a level which will result in some reasonable surplus being shown in order to provide for any claim that may arise in respect to insured export sales outstanding. But, as at December 31st, 1961, the Corporation showed that the excess of its premium income over operating expense and net claims paid for the seventeen years since the Corporation commenced operations in 1945 amounted to approximately $1,965,000, equal to about 28 per cent of its gross premium income over this period of time. It is possible that a somewhat lower level of excess premium income would have been satisfactory and that the Corporation's premium rates could have been lower than they have been. Had a portion of the surplus been utilized to reduce premiums, it would not likely have resulted in any significant lowering of rates charged, certainly in the case of short-term insurance policies where the average premium levied has been less than two-thirds of 1 per cent. In the case of medium-term credits, where the average premium charged has been 3 per cent, individual contract values are often very sizeable and may total some millions of dollars; in such cases a premium difference of even one-half of 1 per cent can amount to a significant sum. It is suggested that the Corporation give particular consideration to the effect on exporters' costs and their competitive position

where medium-term credits for major capital goods contracts are involved.

168. In making this suggestion, however the Association would point out that, in its opinion, in order to strengthen the Corporation's position so that it may use to the maximum extent possible the gross surplus shown on its normal operations in order to reduce premium rates to the minimum prudent level, the major area requiring consideration is that relating to the Corporation's income tax position and this is dealt with separately below.

Effect of Income Tax on Position of Export Credits Insurance Corporation

169. The Corporation's net income before tax consists of excess of premium income over operating expense and claims paid to policy holders, and interest on investments (largely representing the Corporation's capital and underwriting reserve).

170. The Corporation is a proprietary Crown Company listed in Schedule "D" to the Financial Administration Act and is subject to income tax. During its first fifteen years of operation, the Corporation did not have to pay any income tax (except for the year 1954 when some $300,000 in taxes were paid), on the basis that it would be first allowed to build up out of its annual earnings an underwriting reserve of $5 million. This point was reached in 1960 and since that time the Corporation has had to pay income taxes, which for the year 1961 alone totalled $740,000. The Corporation's net income for the year 1961 consisted of:

Excess of premium income over operating expenses and claims paid to policy holders (net)	$ 810,000
Interest on investments	678,000
Gross income before tax	1,488,000
Provision for income tax	740,000
Net income for the year	$ 748,000

171. As stated earlier, the Corporation's aim is to provide insurance on a cost basis, its objective being to charge premiums at rates which, in the long run, will meet its operating expenses and the net claims which it has to pay. Because the Corporation has had to pay income tax for 1961, the amount of the excess of premium income over expense and policy holders' claims (net) for that year which could have been used to reduce future insurance premiums in line with the Corporation's policy of operating on a cost basis has been very materially reduced, viz., from $810,000 to one-half that amount. It is significant to note that gross premium income in the same year was only $744,356.

172. The Association considers that the Corporation should not have to pay income tax. In other countries, the agency responsible for extending export insurance is usually a government department (rather than a separate government-owned corporation, as is the case in Canada) and does not have to pay income tax. It is pointed out that a somewhat comparable institution in Canada, the Industrial Development Bank, is placed in a different category of government agency and is not subject to income tax. The Association recommends:

(a) that the portion of Export Credits Insurance Corporation's net annual earnings represented by the excess of premium income over operating expenses and claims paid to policy holders should be exempted from income tax so that the full amount of such excess will be available to reduce premium rates, and

(b) that, whilst it might be considered that the part of the Corporation's annual net earnings which is accounted for by interest on investments should be subject to income tax, this part of the net earnings should also be exempted from income tax and that the whole of such portion of the earnings be used to further build up the Corporation's underwriting reserve.

173. The adoption of these recommendations would enable the Corporation to carry out fully its aim of providing insurance on a cost basis, thus improving the competitive position of Canadian exporters, and would at the same time serve to build up the Corporation's financial reserves.

EXPORT FINANCING

Short-Term and Medium-Term Financing

174. If a company secures an export order which is covered by an insurance policy from Export Credits Insurance Corporation limiting the liability of the exporter to 15 per cent of any loss which may be incurred,

it should be able to secure the necessary financing in addition to the total amount of financing it otherwise requires to cover the balance of its business. The fact that Export Credits Insurance Corporation, which is responsible for 85 per cent of the net loss, will agree to pay any Canadian chartered bank the proceeds of any claim payable under a policy should help an exporter to secure the additional financing required.

175. From replies received to the Association questionnaire on the subject, however, it is apparent that some exporting members still encounter difficulties in financing export sales providing for short and medium credit terms. In the few cases where problems are reported in short-term financing there may be indications of a need, as has frequently been suggested, for re-discount facilities for insured export paper where recourse would be limited to his 15 per cent share under the co-insurance principle. This matter should be given further study.

176. The position of Canadian exporters from the standpoint of securing necessary additional financing for medium-term export business has recently been improved by the setting up of Export Finance Corporation of Canada, Ltd., which was organized by the chartered banks specifically for the purpose of financing medium-term export paper against the security of policies issued by Export Credits Insurance Corporation.

177. As stated earlier, the maximum (and usual) portion of any loss for which Export Credits Insurance is responsible is 85 per cent, leaving the exporter to

bear 15 per cent. In the case of medium-term contracts, i.e., involving terms extending up to five years after date of shipment, the exporter can accordingly be on risk for a fairly lengthy period of time. A transaction involving four or five year terms would likely be of fairly substantial amount, with the result that even with a limitation of 15 per cent the gross contingent liability of the exporter could amount to a substantial sum of money. In such cases, an exporter in establishing his selling price would almost certainly have to include in his costs a special reserve in recognition of the possible loss he might have to face. In some cases, the size of the possible loss to an exporter under the present co-insurance arrangements could be such that it would be high in relation to the exporter's overall financial strength, with the result that he might be precluded from receiving the necessary financing, even though he were able to secure export credits insurance. It is understood that in some countries the agency responsible for extending export insurance is prepared to insure to a greater extent than 85 per cent and have been known to grant coverage up to as high as 95 per cent.

178. The Association recommends that consideration be given by Export Credits Insurance Corporation to increasing the percentage of loss for which it will be responsible in appropriate cases involving medium-term credits in order to assist exporters:

(a) to reduce their costs, so placing them in a more competitive position, and

(b) to secure the additional financing required to support such export business.

Long-Term Financing

179. In 1961, the Government introduced long-term financing facilities for export sales of capital goods. As a result of these new facilities, Canadian exporters have for the first time been placed in a position to compete for this type of business in world markets. Since the introduction of this new legislation a substantial amount of new export business, which would not otherwise have been secured, has been obtained by Canadian manufacturers.

180. The new direct long-term financing programme is administered by Export Credits Insurance Corporation on behalf of the Government. Under the new arrangements, the Canadian supplier does not himself have to supply the credit and accordingly no export credits insurance is required as in the case of medium-term exports. Promissory notes or other payment instruments for amounts due under the contract are given by the foreign buyer to the Canadian exporter and these in turn are guaranteed by Export Credits Insurance Corporation without recourse against the exporter. The exporter may then sell the guaranteed instruments at full value and accordingly receives payment for his contract by the time he has completed delivery.

181. The present system calling for this issue of promissory notes by the foreign buyer to the Canadian exporter, the guarantee of the notes and then their subsequent sale appears to be somewhat cumbersome and the

Association suggests that the provisions of Section 21A of the Export Credits Insurance Act be re-drafted so that the procedure is simplified.

182. During the past year, since the new direct long-term financing arrangements were provided by the Government, Export Credits Insurance Corporation has signed contracts covering approximately $50 million of capital goods sold in foreign markets. In addition, commitments have been given to Canadian exporters in connection with the financing of prospective export orders totalling in excess of $100 million. The $50 million of contracts which have already been signed have been with six companies, all of whom are members of this Association. The executives of these companies have all commented most favourably on the calibre of the staff of Export Credits Insurance Corporation and have spoken highly of the wholehearted co-operation which the Corporation has shown. Applications to the Corporation for long-term financing have been handled expeditiously and with a minimum of delay. Negotiations for long-term financing contracts necessarily involve the advice and assistance of the Department of Trade and Commerce, supported by its representatives in overseas countries, and these members of the Association have also paid high tribute to the co-operation and assistance which has been received by them from Canada's overseas Trade Commissioners.

Appendix VIII

SUFFICIENCY OF SUPPLY OF CAPITAL

183. The Association asked all its members: "Can you get sufficient short-term capital? Can you get

sufficient long-term capital?" Answers are analyzed in Tables 9 and 10.

184. Of all respondents to the questionnaire, 6.5 per cent said they could not get sufficient short-term capital. Non-response to this particular question does not affect the result much, since 7.4 per cent of those answering the question said they could not get sufficient short-term capital.

185. By comparison 18.1 per cent of all respondents to the questionnaire, and 24.9 per cent of all those who answered the question, said they could not get sufficient long-term capital.

186. Some 83 per cent of all those firms reporting insufficient short-term capital and 90 per cent of those reporting insufficient long-term capital were private companies controlled in Canada. (The latter classification of firm constituted, by comparison, 56.2 per cent of all respondents to the questionnaire).

187. The numbers of reports of insufficient capital from other types of firms were small and do not present any clear pattern when broken down by size-class. However, a comparison of size and the percentage of reports of insufficient capital shows that the smaller firms have the highest rate of such reports for private companies controlled in Canada answering the questionnaire.

Percentage of All Canadian-Controlled Private Companies Reporting Insufficient Capital, by Sales Class

Sales Class	Insufficient Short-term Capital	Insufficient Long-term capital
Under $250,000	18.5%	40.0%
Over $250,000 Under $1 Million	10.5%	33.9%
Over $1 Million Under $10 Million	4.3%	19.1%
$10 Million or Over	Nil	11.1%

188. While there might be differences in the definitions of long-term capital used by different manufacturers, it seems likely that the over-all pattern of the replies has not been affected greatly. What definitely would make a difference to the interpretation of these answers, of course, is the varying ability of respondents to absort extra capital; it was not considered feasible to take this into account in the questions as it would have required a detailed enquiry into each firm's financial position, which might still not provide the complete picture. The answers, however, may shed some limited light on the incidence of difficulties in obtaining capital among those answering the questionnaire.

Appendix IX

ATTITUDE TOWARD INVESTMENT COMPANIES

189. A question the results of which may be of some interest to those in a position to invest in Canadian industry was put as follows to members of the Association: "If there were more private enterprise investment companies specializing in making diversified

investments in the common stock or convertible debentures of small manufacturing firms not owned by the public with a view to such manufacturers expanding and eventually 'going public', might your company be interested in receiving such funds?" The answers are analyzed in Table 11.

190. The question applied only to private companies. Almost all the "Yes" answers were from companies controlled in Canada, although five respondents controlled outside Canada said they might be interested in such investment money.

191. Of private companies controlled in Canada, 25.8 per cent said they might be interested in receiving such investment money.

192. It is, of course, not possible to say how many of those who answered could benefit from additional investment or eventually "go public". The results are, however, presented for their interest.

Appendix X

EQUIPMENT LEASING

193. Members of the Association we asked: "Would more widely available facilities for long-term leasing of machinery make much practical difference to you as a machinery user?" Replies are analyzed in Table 12.

194. Not quite 15 per cent of respondents to the questionnaire replied "Yes" to this question, and 72.7 per cent replied "No". The remainder did not answer the question.

195. "Yes" answers were concentrated among private companies controlled in Canada, where 22 per cent of all

respondents to the questionnaire said more widely available facilities for leasing would be useful to them.

196. Leasing is, of course, something which varies greatly in its practicability with the industry involved and the type of equipment used. It did not seem possible to take this into account in the questionnaire. If industries where leasing would not be expected to be sought could be excluded, the percentage of "Yes" answers among the remaining returns might be higher.

Appendix XI

SOURCES OF START-UP AND EXPANSION MONEY

197. To get an impression of the relative importance of different sources of financing in the founding of new manufacturing businesses, the Association asked its membership: "If you commenced business within the last 30 years, where was the first money used to start the business obtained?"

198. Because percentages were asked for and these percentages apply to widely differing totals, average percentages for all firms replying would not give a valid measure of overall sources of capital. It is believed, however, that the detailed results may be of value in studying the needs of industry and they are presented in Tables 13 and 14. In view of their complexity, they will not be analyzed here, but some general conclusions cn be drawn:

(a) The tables show that savings are the most frequently used source of capital for new manufacturing businesses. (This supports the view of the Association

that too-high personal income tax rates can hinder the ability of the economy to grow).

(b) The chartered banks were the second most frequent source of capital for the reporting manufacturers when they were commencing business.

(c) The Industrial Development Bank was the fifth most frequent source of capital for Canadian-controlled private companies.

(d) The answers to this question are dominated by small private companies; the amounts of capital derived from the owner's savings in individual returns would point to this as the largest as well as the most frequent source of money for new small private companies.

199. A similar question was also asked about where the money came from after the firm was in business: "During the period of becoming established, where were subsequent moneys for the expansion of the business obtained?" The answers were tabulated only for those in business 30 years or less, the same group covered by the preceding question about start-up money.

200. The replies are presented in Table 15. Again, they do not lend themselves to totalling or averaging and are somewhat complex. A few simple conclusions, however, are:

(a) Retained profits are the source

of expansion money most frequently relied upon.

(b) Of those reporting retained profits as a source of expansion money, nearly one-third obtained 90 per cent or more of their expansion money from this source. Nearly 79 per cent of firms relying on retained profits obtained half or more their expansion money from profits.

(c) The chartered banks were the second most frequently reported source of expansion money. The importance of the banks to manufacturers is emphasized by the fact that 81 per cent of those reporting using them to finance expansion got 20 per cent or more of their expansion money there.

(d) The Industrial Development Bank is the third most frequently reported source of expansion money. It too plays a sizeable role in the finances of those who report having used it.

Appendix XII

TABLES

201. The following tables summarize answers to the questionnaire which the Association sent to all its members in preparation for this submission. The questions summarized are those referred to in the preceding appendices.

202. "Total Returns" always refers to the "total returns tabulated" category used in the discussion in the other appendices. There were some returns received too late for tabulation, although written comments and suggestions in all returns were taken into consideration.

203. It will be noticed that the answers -- "Yes", "No", or otherwise, depending on the question -- do not add up to the figures shown under "Total Returns." This is because of respondents who did not answer the particular question. A complete tabulation would include figures for the number of "No Answer" returns on each question, but this would have expanded the space required considerably.

204. In Tables 13, 14 and 15, the figures in the righthand column add to more than the number of returns tabulated since most respondents marked more than one source of money. In these questions, the total number of returns tabulated is the number of returns of firms reporting that they have been in business 30 years or less. Although other companies answered the question in Table 15, only those in business 30 years or less were tabulated.

205. In the type-of-ownersship classification, the

heading "Other Firms" refers chiefly to unincorporated firms and to some respondents which did not indicate type of ownership.

206. These tables consist entirely of number of returns tabulated and of returns giving particular answers. Results of the questionnaire in terms of percentages of respondents giving various answers are given for many of the questions in the preceding appendices.

Question: Which of the following general economic conditions in the country have most influenced your decisions to undertake capital expenditures during the post-war period? (Please rank in order of importance, i. e., as 1, 2, 3 or do not mark if not important.)

	Number of First Rankings	Number of Second Rankings	Number of Third Rankings
Sales Under $250,000			
Fluctuations of interest rates	-	8	6
Tight money during certain periods	10	5	4
Depreciation rates permitted under the Income Tax Act	14	5	3
Sales $250,000, Under $1 Million			
Fluctuations of interest rates	3	9	7
Tight money during certain periods	18	7	6
Depreciation rates permitted under the Income Tax Act	31	5	3
Sales $1 Million, Under $10 Million			
Fluctuations of interest rates	5	14	14
Tight money during certain periods	24	14	5
Depreciation rates permitted under the Income Tax Act	49	5	9
Sales Over $10 Million			
Fluctuations of interest rates	-	3	4
Tight money during certain periods	-	4	2
Depreciation rates permitted under the Income Tax Act	17	-	-
All Sales Class			
Fluctuations of interest rates	8	34	31
Tight money during certain periods	52	30	17
Depreciation rates permitted under the Income Tax Act	111	15	15

TABLE 2

Question: If income tax depreciation regulations permitted a tax write-off of depreciable assets in half the time presently permitted, would your firm's capital expenditure have been greater in the last ten years?

Sales Class of Respondent	Private Companies: Controlled In Canada				Private Companies: Controlled Outside Canada				Public Companies: Controlled In Canada				Public Companies: Controlled Outside Canada				Other				Total			
	S	M	N	T	S	M	N	T	S	M	N	T	S	M	N	T	S	M	N	T	S	M	N	T
Under $250,000	-	17	36	65	-	-	3	3	-	1	-	1	-	-	-	-	-	2	8	13	-	20	47	82
Over $250,000, Under $1 Million	14	55	43	124	4	5	14	26	1	2	2	5	-	-	-	-	-	1	1	3	19	63	60	158
Over $1 Million, Under $10 Million	18	39	43	115	5	24	52	80	1	9	13	26	4	7	12	23	-	-	1	2	28	79	121	246
$10 Million or Over	1	1	6	9	1	3	12	16	1	11	12	26	-	10	7	20	-	-	-	-	3	25	37	71
All Sales Classes	33	112	128	313	10	32	81	125	3	23	27	58	4	17	19	43	-	3	10	18	50	187	265	557

S: Yes (substantially); M: Yes (moderately); N: No; T: Total returns tabulated.

Answers do not add to Total Returns as some respondents did not answer particular questions.

TABLE 3

Question: Did your firm have difficulty in obtaining desired bank credit in 1956 or 1959?

Sales Class of Respondent	Private Companies: Controlled In Canada			Private Companies: Controlled Outside Canada			Public Companies: Controlled In Canada			Public Companies: Controlled Outside Canada			Other Firms			Total		
	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns
Under $250,000	21	39	65	-	1	3	-	1	1	-	-	-	3	6	13	24	47	82
Over $250,000, Under $1 Million	25	91	124	-	22	26	1	3	5	-	-	-	1	2	3	27	118	158
Over $1 Million, Under $10 Million	19	89	115	1	67	80	1	23	26	1	17	23	-	1	2	22	197	246
$10 Million or Over	2	6	9	-	15	16	2	22	26	-	16	20	-	-	-	4	59	71
All Sales Classes	67	225	313	1	105	125	4	49	58	1	33	43	4	9	18	77	421	557

TABLE 4

Question: Have you ever attempted to obtain a term loan from a chartered bank--that is, a loan of more than one year original maturity or funds furnished through the direct sale to a bank of a firm's own corporate bonds or debentures of more than one year's maturity? (Do not include loans under the Small Businesses Loans Act.)

Sales Class of Respondent	Private Companies: Controlled In Canada				Private Companies: Controlled Outside Canada				Public Companies: Controlled In Canada				Public Companies: Controlled Outside Canada				Other Firms				Total			
	S	U	N	T	S	U	N	T	S	U	N	T	S	U	N	T	S	U	N	T	S	U	N	T
Under $250,000	6	5	42	65	-	-	1	3	-	-	1	1	-	-	-	-	2	-	7	13	8	5	51	82
Over $250,000, Under $1 Million	13	5	88	124	2	-	17	26	1	-	2	5	-	-	-	-	-	-	2	3	16	5	109	158
Over $1 Million, Under $10 Million	18	2	81	115	15	-	49	80	11	1	12	26	4	-	14	23	-	-	1	2	48	3	157	246
$10 Million or Over	3	-	5	9	5	1	10	16	6	-	14	26	5	1	10	20	-	-	-	-	19	2	39	71
All Sales Classes	40	12	216	313	22	1	77	125	18	1	29	58	9	1	24	43	2	-	10	18	91	15	356	557

S: Successfully; U: Unsuccessfully; N: Have never sought such a loan; T: Total returns tabulated.

Answers do not add to Total Returns as some respondents did not answer particular questions.

TABLE 5

Question: Would you wish to obtain a term loan (other than a loan under the Small Businesses Loans Act) if such loans were more widely available?

Sales Class of Respondent	Private Companies						Public Companies						Other Firms			Total		
	Controlled In Canada			Controlled Outside Canada			Controlled In Canada			Controlled Outside Canada								
	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns
Under $250,000	28	29	65	-	1	3	-	1	1	-	-	-	4	9	13	32	40	82
Over $250,000, Under $1 Million	47	58	124	1	15	26	-	3	5	-	-	-	-	2	3	48	78	158
Over $1 Million, Under $10 Million	35	59	115	5	59	80	4	19	26	2	17	23	-	1	2	46	155	246
$10 Million or Over	3	3	9	3	12	16	5	15	26	4	9	20	-	-	-	15	39	71
All Sales Classes	113	149	313	9	87	125	9	38	58	6	26	43	4	12	18	141	312	557

Answers do not add to Total Returns as some respondents did not answer particular questions.

TABLE 6

Question: Does the bank ever require you to keep a minimum percentage of your loan, or a certain sum, on deposit as a condition of making you a loan?

Sales Class of Respondent	Private Companies: Controlled In Canada			Private Companies: Controlled Outside Canada			Public Companies: Controlled In Canada			Public Companies: Controlled Outside Canada			Other Firms			Total		
	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns
Under $250,000	5	54	65	-	-	3	-	1	1	-	-	-	1	8	13	6	63	82
Over $250,000, Under $1 Million	11	97	124	-	15	26	-	3	5	-	-	-	-	3	3	12	118	158
Over $1 Million, Under $10 Million	8	97	115	2	46	80	1	22	26	1	16	23	-	1	2	12	182	246
$10 Million or Over	-	7	9	-	12	16	-	20	26	1	14	20	-	-	-	1	53	71
All Sales Classes	24	255	313	2	73	125	2	46	58	2	30	43	1	12	18	31	416	557

Answers do not add to Total Returns as some respondents did not answer particular questions.

TABLE 7

Question: Has the bank raised this requirement during periods of scarce credit?

Sales Class of Respondent	Private Companies: Controlled In Canada			Private Companies: Controlled Outside Canada			Public Companies: Controlled In Canada			Public Companies: Controlled Outside Canada			Other Firms			Total		
	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns
Under $250,000	3	20	65	-	-	3	-	1	1	-	-	-	2	2	13	5	23	82
Over $250,000, Under $1 Million	3	35	124	-	4	26	-	1	5	-	-	-	1	1	3	4	41	158
Over $1 Million, Under $10 Million	1	31	115	-	19	80	2	5	26	-	8	23	-	-	2	3	63	246
$10 Million or Over	-	2	9	-	4	16	1	7	26	-	4	20	-	-	-	1	17	71
All Sales Classes	7	88	313	-	27	125	3	14	58	-	12	43	3	3	18	13	144	557

Answers do not add to Total Returns as some respondents did not answer particular questions.

TABLE 8

Questions on the Foreign Exchange Rate

		Returns Postmarked		
		May 2 or earlier	May 3 or later	Total
1. Did the recent depreciation of the Canadian dollar in terms of U. S. funds:				
(a) Increase your export sales (if you export)?	Yes	22	44	66
	No	76	169	245
	Total	98	213	311
(b) Increase your domestic sales because of higher prices for imports which compete with your products?	Yes	37	57	94
	No	88	169	257
	Little or no import competition	40	60	100
	Total	165	286	451
(c) Increase your costs because of higher prices for imported materials or parts?	Yes	154	272	426
	No	25	43	68
	Total	179	315	494
2. If your answer to the last question (part c) was Yes, did this cause an increase in your selling price?	Yes	55	112	167
	No	102	151	253
	Total	157	263	420
3. (a) Are you now making or contemplating making new products in Canada which because of competition would not have been possible before the depreciation of the Canadian dollar?	Yes	29	56	85
	No	152	263	415
	Total	181	319	500
(b) Do you find fluctuation in the foreign exchange value of the Canadian dollar is ever a serious problem in your day-to-day business operations (as, e. g., in making price quotations, purchases, etc.)?	Yes	69	131	200
	No	118	184	302
	Total	187	315	502

TABLE 8 (Continued)

		Returns Postmarked		
		May 2 or earlier	May 3 or later	Total
3. (Cont'd)				
(c) Have recent fluctuations in the foreign exchange value of the Canadian dollar caused you to refrain from undertaking capital investments or to reduce them?	Yes	13	27	40
	No	160	285	445
	Total	173	312	485
(d) If answer to (c) is Yes, is this a case of:				
Waiting till rate is more favourable or stable?		7	15	22
Being unwilling to invest at all because of possible future instability?		8	12	20
	Total	15	27	42
4. (a) Do you buy or sell foreign currencies for use in your business to any appreciable extent?	Yes	67	118	185
	No	121	196	317
	Total	188	314	502
(b) If so, do you buy or sell forward exchange to "hedge" your foreign trade or financial transactions?	Usually	7	23	30
	Frequently	12	22	34
	Never or not frequently	80	135	215
	Total	99	180	279
(c) Would you like to see a "pegged" foreign exchange value for the Canadian dollar?	Yes	90	169	259
	No	18	41	59
	Have no strong opinion	72	112	184
	Total	180	322	502
	Total number of returns tabulated	209	348	557

TABLE 9

Question: Can you get sufficient short-term capital?

Sales Class of Respondent	Private Companies: Controlled In Canada			Private Companies: Controlled Outside Canada			Public Companies: Controlled In Canada			Public Companies: Controlled Outside Canada			Other Firms			Total		
	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns
Under $250,000	45	12	65	1	-	3	1	1	1	-	-	-	7	3	13	54	16	82
Over $250,000, Under $1 Million	93	13	124	20	-	26	4	-	5	-	-	-	1	-	3	118	13	158
Over $1 Million, Under $10 Million	97	5	115	70	1	80	26	-	26	18	-	23	1	-	2	212	6	246
$10 Million or Over	8	-	9	15	-	16	24	1	26	19	-	20	-	-	-	66	1	71
All Sales Classes	243	30	313	106	1	125	55	2	58	37	-	43	9	3	18	450	36	557

Answers do not add to Total Returns as some respondents did not answer particular questions.

TABLE 10

Question: Can you get sufficient long-term capital?

Sales Class of Respondent	Private Companies: Controlled In Canada			Private Companies: Controlled Outside Canada			Public Companies: Controlled In Canada			Public Companies: Controlled Outside Canada			Other Firms			Total		
	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns
Under $250,000	19	26	65	1	-	3	1	-	1	-	-	-	4	4	13	25	30	82
Over $250,000, Under $1 Million	46	42	124	15	1	26	3	1	5	-	-	-	-	-	3	64	44	158
Over $1 Million, Under $10 Million	58	22	115	57	1	80	22	1	26	17	-	23	-	-	2	154	24	246
$10 Million or Over	7	1	9	15	-	16	22	2	26	18	-	20	-	-	-	62	3	71
All Sales Classes	130	91	313	88	2	125	48	4	58	35	-	43	4	4	18	305	101	557

Answers do not add to Total Returns as some respondents did not answer particular questions.

TABLE 11

Question: If there were more private enterprise investment companies specializing in making diversified investments in the common stock or convertible debentures of small manufacturing firms not owned by the public, with a view to such manufacturers expanding and eventually "going public", might your company be interested in receiving such funds?

	Private Companies						Public Companies											
	Controlled In Canada			Controlled Outside Canada			Controlled In Canada			Controlled Outside Canada			Other Firms			Total		
Sales Class of Respondent	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns
Under $250,000	18	25	65	-	3	3	*	*	1	*	*	-	3	7	13	21	35	82
Over $250,000, Under $1 Million	37	34	124	1	17	26	*	*	5	*	*	-	-	1	3	38	52	158
Over $1 Million, Under $10 Million	25	24	115	4	29	80	*	*	26	*	*	23	-	-	2	29	53	246
$10 Million or Over	1	2	9	-	9	16	*	*	26	*	*	20	-	-	-	1	11	71
All Sales Classes	81	85	313	5	58	125	*	*	58	*	*	43	3	8	18	89	151	557

Note: "No" in the above question read "No, or not likely" on the questionnaire.

* Not applicable.

Answers do not add to Total Returns as some respondents did not answer particular questions.

TABLE 12

Question: Would more widely available facilities for long-term leasing of machinery make much practical difference to you as a machinery user?

Sales Class of Respondent	Private Companies						Public Companies						Other Firms			Total		
	Controlled In Canada			Controlled Outside Canada			Controlled In Canada			Controlled Outside Canada								
	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns	Yes	No	Total Returns
Under $250,000	14	43	65	-	3	3	-	1	1	-	-	-	3	8	13	17	55	82
Over $250,000, Under $1 Million	37	75	124	1	26	26	3	1	5	-	-	-	-	2	3	41	104	158
Over $1 Million, Under $10 Million	16	77	115	2	67	80	-	23	26	3	16	23	-	2	2	21	185	246
$10 Million or Over	2	7	9	1	14	16	1	22	26	-	18	20	-	-	-	4	61	71
All Sales Classes	69	202	313	4	110	125	4	47	58	3	34	43	3	12	18	83	405	557

Answers do not add to Total Returns as some respondents did not answer particular questions.

Question: If you commenced business within the last 30 years, where was the first money used to start the business obtained? (Please estimate percentages roughly.)

NUMBER OF FIRMS REPORTING SPECIFIED PERCENTAGE OF INITIAL MONEYS OBTAINED

FROM SPECIFIED SOURCE

Source of Funds	(Percentage of Total Moneys Obtained)										Total Number of Returns Citing Source
	1%-9%	10%-19%	20%-29%	30%-39%	40%-49%	50%-59%	60%-69%	70%-79%	80%-89%	90%-100%	
	(Number of Firms Reporting)										
Owner's Savings	2	6	19	8	6	27	2	14	13	55	152
Borrowing from Friends or Relatives	-	12	15	5	5	5	3	2	3	1	51
Borrowing from the Bank	3	8	27	7	5	18	4	1	2	5	80
Borrowing from the Industrial Development Bank	3	1	3	2	4	1	-	1	-	-	15
Other Borrowings	1	3	4	2	1	4	-	5	-	3	23
Sales of Shares to a Limited Group	3	4	6	2	2	10	3	3	-	27	60
Sale of Shares to the Public	1	1	2	1	-	1	1	-	-	1	8
Other	1	4	1	1	1	4	1	1	1	33	48

Note: Total number of returns tabulated, 287.

Question: If you commenced business within the last 30 years, where was the first money used to start the business obtained? (Please estimate percentages roughly.)

NUMBER OF CANADIAN-CONTROLLED PRIVATE COMPANIES REPORTING PERCENTAGE OF INITIAL

MONEYS OBTAINED FROM SPECIFIED SOURCE

Source of Funds	1%-9%	10%-19%	20%-29%	30%-39%	40%-49%	50%-59%	60%-69%	70%-79%	80%-89%	90%-100%	Total Number of Returns Citing Source
	(Percentage of Total Moneys Obtained)										
	(Number of Firms Reporting)										
Owner's Savings	2	4	18	7	6	25	1	13	11	41	128
Borrowing from Friends or Relatives	-	12	12	5	5	4	3	2	3	1	47
Borrowing from the Bank	3	7	25	6	4	16	3	1	2	2	69
Borrowing from the Industrial Development Bank	-	-	3	1	4	1	-	1	-	-	10
Other Borrowings	-	2	3	1	-	3	-	1	-	-	10
Sales of Shares to a Limited Group	-	3	4	1	2	7	2	2	-	8	29
Sale of Shares to the Public	-	-	1	-	-	-	-	-	-	-	1
Other	1	4	1	1	1	3	-	-	1	6	18

Note: Total number of returns tabulated, 176.

Question: During the period of becoming establishes, where were subsequent moneys for the expansion of the business obtained? (Please estimate percentages roughly.)

NUMBER OF FIRMS REPORTING SPECIFIED PERCENTAGE OF EXPANSION MONEYS OBTAINED

FROM SPECIFIED SOURCE

Source of Funds	1%-9%	10%-19%	20%-29%	30%-39%	40%-49%	50%-59%	60%-69%	70%-79%	80%-89%	90%-100%	Total Number of Returns Citing Source
	(Percentage of Total Moneys Obtained)										
	(Number of Firms Reporting)										
Retained Profits	2	11	12	6	6	40	12	17	11	57	174
Borrowing from Friends or Relatives	3	8	9	1	1	7	-	-	-	-	29
Borrowing from the Bank	4	19	32	15	7	20	4	3	4	14	122
Borrowing from the Industrial Development Bank	3	4	19	5	3	9	3	1	-	2	49
Other Borrowings	2	6	6	3	2	4		2	2	3	30
Sale of Shares to a Limited Group	4	6	6	4	2	6		-	-	3	32
Sale of Shares to the Public	1	2	1	-	1	-	-	1	-	-	7
Other	3	1	-	1	-	1	1	2	1	15	25

Note: Total number of firms tabulated, 287. All tabulations refer to firms in business for 30 years or less.

Royal Commission on Banking and Finance

PROFESSOR VINER

Hearings held at

OTTAWA

Vol.

41

Date.

SEPT. 19, 1962

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ROYAL COMMISSION ON BANKING AND FINANCE

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Hearings held at Ottawa, Ontario, on Wednesday, September 19th, 1962.

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Ottawa, Ontario
Wednesday, September 19, 1962.

--- At 9.15 A.M. the hearing resumed.

SUBMISSION OF
PROFESSOR J. VINER
OF HARVARD UNIVERSITY

THE CHAIRMAN: I will now call the meeting to order.

This morning we have a submission from Professor Viner. We appreciate very much your presence here this morning, Professor Viner, and we are looking forward to your elaboration of the statement you are presenting to us. I think you would prefer to make a statement at the outset.

PROFESSOR VINER: I would like to repeat the gist of my statement, but in other words, and make some additional points. I will attempt to attain brevity.

The problems of keeping an economy in order are complicated by the fact that normally an economy has a fairly elaborate set of objectives, is not fully conscious of just what these are, has never sat down to decide just what relative weight it will assign to each of these objectives in case of any need of harmonization or reconciliation as in the case of conflict. In addition to that, the management of the economy, in so far as government is managing an economy, is usually assigned on historical grounds among different agencies in a variety of ways, and they are never particularly carefully planned out. These agencies

have acquired traditions of their own and on occasions policies of their own, about which they may be fully aware but of which the rest of government and the community at large may not be.

In addition, the modern economy has to bear with The Economists, and they are there with advice, recommendations and solutions, but they rarely stop to ask what are the objectives of the economy and what the advice is being given for, and they tend, as specialists, to have chosen a goal themselves and to advise means for attaining it to the utmost, without very much consideration for the possibility that there may be other goals.

Still another burden the modern economy has to bear is the confidence existing today in the possibility of prophesying a future trend. While it is true that not a large allocation of purchasing power goes to the support of the operations of building up these statistics, they give a confidence which is not justified philosophically or historically, and I do not have to go very far afield in order to indicate rather striking instances of great confidence expressed in anticipations over the next few years, or next decade, or next few months, of how an economy is going to operate which proved to be misplaced.

In order not to give an illustration too close to your home, though I could if I wanted to, I will cite the American experience just this year, in 1962, where, with what I think is probably the most

[illegible] of their own, and on occasions
difficulties of their own, about which they may be fully aware but of which the rest of government and the community at large may not be.

In addition, the modern economy has to deal with the Economists, and they are there with advice, recommendations and solutions, but they rarely stop to ask what are the objectives of the economy and what the advice is being given for, and they usually, as scientists, to have chosen a goal themselves and to advise means for attaining it to the utmost, without very much consideration for the possibility that there may be other goals.

Still another burden the modern economy has to bear is the confidence existing today in the inevitability of prosperity [illegible] future [illegible]. While it is true that only a [illegible] fraction of purchasing power goes to the support of the operations of building up these [illegible], they give a confidence which is not justified [illegible] or historically, and I do not have to go very far afield in order to [illegible] instances of great confidence expressed in anticipations over the next few months, or next decade, or next few months, of what the economy is going to [illegible] which proved to be [illegible].

In order not to give an illustration too close to home, however, I could [illegible] wanted to, use the American experience just this year.

ably staffed body of economic advisers the United States has ever had, in whose general technical skill I have the greatest of confidence and admiration, nevertheless they started out this year, with full confidence that they could predict what the Gross National Product would be and what the course of the employment trend would be. I saw them, in the course of their forecasting, with the gleam of confidence on their faces; and yet it took just six weeks for these forecasts to show signs of having been sour, and now they are very sour and sick. Next year they will be prophesying the same way, with unimpaired confidence in their skill. The forecasters are doing as well as human beings can, except for the available alternative of remaining silent.

They are attempting a task for which there is no logical justification. The justification they present is highly technical, skilled and highly learned, but it belongs to a world in which the outcome is not the result sometimes of relatively few decisions of a relatively few powerful men. The techniques are suitable only for physical phenomena where there are infinite variables, which are homogeneous and where the universe as a whole is a stable one.

I am not saying: Don't look forward; don't take a long view. I do think you can foresee a lot and predict a lot. You can predict, for instance, that if you use the printing press very heavily the direction of your impact on the national stock of money and the price level will be upward and not downward. The economists and the statesmen can predict, within limits,

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the direction in which a particular act of legislation or a particular event impinging on your economy from outside is going to affect or influence the economy; the direction of this influence.

What I believe neither an economist nor anybody else can forecast is what I call "events", the whole conjuncture of the state of an economy. That conjuncture is always the result of many variables which shift in importance through time and which are unstable through time. What we know, within limits which are unfortunately not too broad, is that certain kinds of action will produce an impact in a certain direction, but there may occur other actions operating in the other direction, so that the net effect will be the reverse of the impact of the first action. I would not call that a false forecast, in that sense, if you recognize the limitations and distinguish between impact and event.

In addition to this is the problem in government of assigning functions to agencies. If the government has, as it will inevitably have, a fairly large set of objectives; if it has, as I say it will have, inadequate conscience of what these objectives are; if it is in doubt as to what relative weight to assign to these objectives; how does it assign mandates to its agency, particularly if it wants it to work under a very specific mandate, according to a rule or body of rules or a strict code? How can you reconcile plural and inconstant objectives and specific and constant mandates?

Basically, I think you cannot reconcile these,

the direction in which a particular act of legislation or a particular event impinging on your economy from outside is going to affect or influence the economy; the direction of this influence.

What I believe neither an economist nor anybody else can forecast is what I call "events", the whole conjuncture of the state of an economy. That conjuncture is always the result of many variables which shift in importance through time and which are mutually more [illegible]ther. What we know, within limits which are fortunately not too broad, is that certain kinds of action will produce an impact in a certain direction, but there may occur other actions operating in the other direction, so that the net effect will be the reverse of the impact of the first action. I would not call that a false forecast, in that sense, if you recognize the limitations and distinguish between impact and effect.

In addition to this is the problem in government of assigning functions to agencies. If the government has, or it will inevitably have, a fairly large set of objectives; if it does, as I say it will have, inadequate consciousness of what these objectives are; if it is in doubt as to what relative weight to assign to these objectives; how does it assign mandates to its agency, particularly if it wants it to work under a very specific mandate, according to a rule or body of rules or a strict code? How can you reconcile plural and incongruous objectives and political and concrete

and, you therefore have to feel your way by trial and error, using all the information, judgment and wisdom you can acquire, and also other qualities that pass as or masquerade as judgment and information.

There is one thing you can do, as a pattern and a general idea, and I think it is very pertinent to some of the problems which are in my mind in connection with the function of this Commission, as I see it, as, for instance, what are the functions of the central bank?

A government or community can make up its mind, substantially, that there is a certain goal to which it attaches a great degree of importance, so it will stand by it and support it, even though at a given time it seems to be conflicting with some other goal or goals.

Let me assume that that goal is stabilization of the price level, of the purchasing power of the Canadian dollar. There may have been assigned to a central bank the function of using, to the best of its abilities and to its utmost powers, all those tools which it is permitted to use in its operations. Then if the mandate were carefully written, it would indicate, is it a long-run or a short-run assignment, or is it both? -- because it would make an important difference for the operator. You would have to tell this central bank: we do not expect you to manage the whole economy; we do not expect you to take ultimate responsibility for all the goals this country has. You ought to try to become aware as to what they are, and you may have alternatives in your mode of operation, one of which will

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hurt a certain objective and the other one of which will not, or will minimize the hurt. But your assignment, until further instructions are received from government, is to do what you can to maintain a stable price level. The treasury may have other objectives which conflict pretty sharply. If they make your task harder, then work harder. If the treasury wants, let us say, to finance on short-term maturities when, in the interest of the goal of stabilization of price levels, long-term maturities would be more to the point, then, whatever instrument the central bank chooses to use, let it use more of it to counter-balance the adverse effect on the price level of the treasury action. In other words, you ought to recognize that if you want agencies to operate by somewhat fixed and stable rules, in terms of a national mandate, you have to permit them to operate against the immediate short-run objectives, at times, of some other agency of the government, which it has pursued under its own mandate.

I would take as an illustration, debt management as an instrument which would have an impact ordimarily on the objectives of a central bank, and yet where a ministry of finance would often, and I would say inevitably, have its own reasons for its decisions.

....

I have had some connection with a ministry of finance, and I think the internal objectives of a ministry of finance are sometimes very strange to look upon for an economist who is thinking only of the economy of a country as a whole. Very often the major goal seems to be to try to minimize the interest cost of the debt to the national economy. That is regarded as a major objective. To me it seems the most minor of objectives, in the light of other goals which the economy, thinking of its problems seriously, would take into account, like price stabilization, full employment and ironing out the business cycle, and so forth.

But it is possible, within limits, for a ministry of finance to have a debt management policy which goes quite counter, say, to price level stabilization, and for a central bank to pursue honestly and effectively a price stabilization policy, and yet to eliminate the conflict between the two, as far as debt management is concerned.

I believe the British pattern of operation does that fairly systematically. As I understand it, the British Treasury decides what the maturity is going to be but it is the Bank of England which decides what the real maturity is going to be of a new financing as far as the outside public is concerned, because it takes over the issue and buys as much of it as it wants to, and lets the rest of it pass for sale to the public, and replaces

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its own investment by some issue which it had in stock of a different maturity. So that there are really at least three average maturities of a public debt. I regard the average maturity of a public debt as a rather important instrument for monetary and fiscal management. I think it has been neglected because ministries of finance have had an excessive range of objectives and there has not been a central bank authorized or permitted, or willing to neutralize the impact of the Treasury's actions on the effective maturity of the debt. I would make more elaborate distinctions were this an operation recommendation, but in brief I distinguish between the average maturity of the debt as the treasury issues it and the effective maturity and I say that the former is of very little consequence under my scheme of management, except to the treasury itself.

What is important is the average maturity of the debt as it leaves the treasury and the central bank; in other words what goes out to the public. Even more important is the average maturity of the debt as it leaves the treasury plus the central bank plus the commercial banking system; in other words, as it gets into the hands of the non-banking public.

The point I want to make is that when there is a conflict of functions or goals between two agencies it may nevertheless still be possible to accomplish the goal or objective which the central bank regards as important. The central bank would need to be equipped with assets, and included in those assets of a central bank, is the key asset of the printing press and also

its own investment by some issue which it had in at of a different maturity, so that there are really at least three average maturities of a public debt. I regard the average maturity of a public debt as a rather important instrument for monetary and fiscal management. I think it has been neglected because authorities in finance have had an excessive range of objectives and there is not only a central bank authorized or permitted, or unwilling to neutralize the impact of the Treasury's actions on the effective maturity of the debt. I would make more elaborate distinctions were this an [illegible], but in brief I distinguish between the average maturity of the debt as the treasury issues it and the effective maturity and I say that the former is of very little consequence under my scheme of management, except to the Treasury itself.

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the machine to cancel money.

Suppose the issue by the treasury is a long-term issue at a time when the central bank would like to have the average maturity of the debt as a whole shortened rather than lengthened. The bank absorbs the long-term issue heavily and re-finances itself by selling some of the bills it has on hand. The total holdings of government securities by the central bank might not change by one dollar. The treasury is happy, because it has accomplished its purpose. The central bank would be reasonably happy because the state of its own finances are not important to it, or should not be, nor to the country. What it has done internally is to shift its holdings of government bonds as between maturities, and what it has done to the economy is that it has not permitted the government financing to change the average maturity of the debt held by the public, in the opinion of the central bank, adversely to the interest of the economy.

Now let me turn to another case where goals may be in conflict. Say a government has a balance of payments deficit. There are many ways of financing a balance of payments deficit; they are all correct, depending on what you want. In some countries many persons think that the most significant concept of a short-term balance of payments deficit would be one that puts downward pressure on the exchange where the exchange is not fixed or rigid. For certain purposes that is an important concept. If, however, the economy is not very much concerned about the value of

its currency on the foreign exchanges and has come to look upon that as a minor matter and not one of great consequence, then obviously that would not be a very significant concept for it, and it would want some other concept of balance of payments deficit or pressure or disequilibrium. It is a little inconsistent for a country that does not care about the stability of its foreign rate of exchange to care about its holdings of foreign liquid assets, because the immediate function of foreign assets is to give you a means of meeting a pressure on your exchange when you do not want it to express itself in its natural way.

However, there is a school of economists who regard concern about the movement of the rate of exchange as substantially illegitimate, on the ground that the exchange rate should be left free to reflect in a healthy way in a healthy market pattern the relative status through time of your economy vis-a-vis the rest of the world. One can present a very persuasive argument for that in terms of traditional economics, because a rate of exchange is a price, and a price has the function of equalizing demand and supply on the market. The rate of foreign exchange is then the free price in a free market, and its fluctuations accomplish a valuable social service. Therefore, you ought to let the foreign exchange float.

On the basis of a sort of ethereal economics, abstracted from many of the facts of the universe, in the actual world, I am a believer in a free market and in the useful function of price in a healthy market,

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However, there is a school of economists who regard concern about the movement of the rate of exchange as something illegitimate, on the ground that the exchange rate should be left free to reflect in a healthy way in a monetary market pattern the relative status through time of your economy vis-a-vis the rest of the world. One can present a very persuasive argument for that in terms of traditional economics, because a rate of exchange is a price, and a price has the function of equalizing demand and supply on the market. The rate of foreign exchange is then the free price in a free market, and its fluctuations accomplish a valuable social service. Therefore, you ought to let the foreign exchange float.

On the basis of a sort of general economics, abstracted from many of the facts of the universe, or [illegible] general, only, I am a believer in [illegible] [illegible] of [illegible] price in a healthy market.

healthily organized. On the whole, that is what I would strive for. That is where my biases lie.

However, it so happens that there are no two prices, probably, that are exactly similar or homogeneous in the world. In any case, the price of your currency, in terms of other currencies, is a very peculiar sort of price in a number of respects. In the first place, it is ideally constituted for speculation. It is absolutely without homogeneity through time and an absolutely homogeneous commodity at any one moment. You know just exactly what you are buying when you buy a Canadian dollar. Therefore, it can be marketed easily. It can be marketed with no necessity for inspecting the particular parcel. This is, I believe, a little more than you can say even for number one Canadian hard. There is no problem of varieties of grade or quality in that sense.

Secondly, there are no tangible or definite limits to the range of possible value of a floating currency; in other words, its possible value in the exchange market. It is not tied to anything solid, either to a demand limit to its ceiling value or a cost limit to how worthless it can become; in that respect it is unlike any other commodity I can think of.

To this proposition before it has been replied that the value of a currency is tied to its purchasing power. If a monetary unit will buy twice as much as another foreign monetary unit, its value will be approximately twice that. I agree, but it is the peculiarity, I believe, of exchange rate fluctuations

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In this proposition before us it has been implied that the value of a currency is tied to the purchasing power of a currency, with which I would agree as part of [illegible] foreign monetary unit, but we will not [illegible] really [illegible] that. I agree [illegible]

that they tend to create their own purchasing power parities. The fluctuations of exchange rates themselves operate on the price levels, so as to make them compare and conform to speculators' anticipations of what they are going to be in the future.

I will make a statement which I ought to warn you that some of my colleagues regard as extreme. I think that the only rock of any solidity that exists even in the United States against a fairly irresponsible degree of inflation engineered by government is the fact that the government is aware of and in some degree shares the aversion of a large body of public opinion to depreciation of the U.S. dollar in terms of gold or of foreign currency.

I have done a limited amount of observing of the Latin American economies. One country, except for a swing of three years in the 1890's, has had inflation steadily, without skipping a year, for some hundred and twenty years. During that period it never reached the dimensions and never acquired the speed in rapid depreciation that it has achieved within the last two or three years. The country has, in some ways, prospered over the years. It is a little hard to prove from that country's record that chronic inflation is a guarantee that the country's economy will not prosper. It is even possible it might have prospered a little more with the inflation than if it had had a conservative and austere government, such as it had for two and a half years in the 1890's.

On the other hand, measured by the normal

measures the economy is much stronger and it has progressed much more rapidly than I think it has in fact. A lot of the figures represent a spurious growth. The gross national product, as authoritatively computed in modern times, included the salaries of government officials whose business it is to suppress production.

In an inflationary economy, a large part of the economy can be engaged in locating the lags in price adjustments and in "curing" bottlenecks by raising prices to the point where supply, scanty as it is, meets the demand. The incomes thus gained find full reflection in the gross national product.

It is arguable that a modest rate of inflation is beneficial. When I say that it is arguable, I mean that I personally don't feel capable of completely rebutting it. It is arguable that a creeping inflation plus general confidence that it will never be allowed to become a galloping one may sometimes overcome certain frictions and certain sluggishness and act as sort of a stimulus which on the whole does move the economy to a little faster pace than it would otherwise attain.

However, that issue hasn't had to be decided in the past. No government that I know of has ever, except indirectly or by implication, committed itself to an absolutely fixed level of prices. Governments have, however, committed themselves to absolutely fixed or substantially fixed rates of exchange. They do that when they give a fixed dollar gold value to their monetary unit, or they do it in terms of the exchange

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rate itself.

In Latin America some four or five countries have followed the path of austerity with respect to their monetary value policy as distinguished from the others which followed the path of galloping inflation at times and, in any case, have not struggled for rigidity with respect to foreign exchange rates.

On the whole I think that the Latin American economies, mostly Central American ones, which followed monetary rigidity or austerity programmes have not moved as rapidly as, say, the Argentine did ten or fifteen or twenty years ago, or perhaps even as Brazil has. Without close scrutiny as to the quality of the movement, austerity has not proved to be a great stimulus to growth nor has it obviously and unambiguously prevented political and social unrest.

A careful student who considers the records of these countries might find that financial rigor doesn't inevitably lead to the most rapid rate of economic progress, and does not always protect you against certain dangers. Its virtues are qualified ones.

A word more on tight money versus easy money as possibly involving a conflict of goals and of agencies. Historically there has been somewhat of a tendency to get very much excited about inflation when deflation seems to be threatening, and to be quite complacent about it when inflation is really going on, and this has been true even of the central bankers. There never has been an occasion in a country

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with a central bank where the central bank has acknowledged that it was one of the agents or a part of the machinery for producing inflation, but the record, I think, speaks otherwise. If the record of central banking relative to its role as a check on inflation -- or for that matter on deflation -- is a very mixed one, one major explanation is that central banks have been charged with a variety of ill-defined functions ahd have usually been unable to follow any one of them rigorously.

THE CHAIRMAN: Thank you very much, Mr. Viner.

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COMMISSIONER GIBSON: Mr. Chairman, I hesitate very much to ask any questions after that most interesting opening statement, but here goes. I would like to ask you a few questions about objectives, if I may, and first of all about the sort of national economic objectives without trying to divide the responsibility up between the central bank and other departments of government.

In your memo you listed the four usual objectives; stable prices, relatively full employment, balance of payments equilibrium or a stable exchange rate and an adequate rate of growth.

Now, I realize that the way in which you go to these objectives varies with the circumstances and with the kind of country which you are talking about, and I wondered if you could give us any rough idea what kind of numbers you might put on them, the ranges of what is reasonable, and I don't know if you want to talk about the United States or Canada. We would be very interested if you would like to tell us what you think is reasonable for Canada. In other words, by stable prices what sort of tolerance in price increase is reasonable?

PROFESSOR VINER: Well, I would say first that I would hope I never would have a precise answer to that sort of question, because I would feel that the process of answering that ought to be a sort of concensus or community or group answer and perhaps in which process the/ views of the participants would change. In other words, I regard certain kinds of problems as problems to which I can

contribute something, but which I wouldn't want to presume for a moment to be able to solve on my own. I would want to solve it in a group and my own experience, in so far as I have had experience in, say, counselling governments, my own experience is that in many cases I have emerged from a decision-making conference with a somewhat different position from that which I entered it with and without full awareness of just at what stage in the discussions my position was changed.

Let us take stable price levels. I think the issue is an important issue on many grounds that I haven't raised, and stability of price levels has many things to be said for it, including ethical things, moral things. Our contracts are made in terms of prices and there ought to be some solidity to the circumstances that enter into the words which are used in the contracts.

Change in a price level is, in part, a process of transferring wealth and income as between different categories of persons, and a great part of that transfer is purely arbitrary and therefore in all probability a part of it, at least, will be highly unjust and inequitable.

Now, the next thing is how rigid should one be? Should one get alarmed because the consumer price index has gone up one-tenth of a per cent? I say no. All things are within reason and there is no series which I know about within one-tenth of a per cent of reliability in any case. The actual margins of error on any series I know about, I am convinced, are many times greater than the statisticians' range of probable error, and I

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would allow a big margin of error, but I wouldn't allow a bias over the years in terms of creeping changes, even if the creeping is always in the same direction. There is a lot to be said for trying to maintain a stable price level, but with the qualification which I have to make, that if you don't have 100 per cent confidence in your index, you had better study it very thoroughly to see whether by maintaining the index stable you are not introducing a fairly substantial drift in the actual price level either upwards or downwards, because the index may have a systematic inflationary bias or deflationary one.

One of the things which I think in general has happened in the past 100 years and I think is still happening -- is that every commodity index has an inflationary bias in the sense that it exaggerates the degree of inflation because the qualities of the commodities have tended to be drifting upwards. The index numbers may, in fact, be announcing an inflation which is not really going on.

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COMMISSIONER GIBSON: Dr. Bernstein when he was here told us that he didn't like the idea of absolute stability in the cost of living index, the consumer price index, because of the element he mentioned, the quality element which you mentioned, and also the very large increasing element of services of the index which, in many cases, almost directly reflected wage rates, since it assumes a certain natural increase in wage rates through the index at its upward trend. He shows as a means, as a measurement, the prices of industrial goods and he said that if you could get them stable you would be doing reasonably well and wouldn't be putting an undue pressure on wages or you wouldn't be limiting your wage increases too much. What do you think of that sort of thing?

PROFESSOR VINER: Well, these increases in the prices of services that reflect predominantly wages, are just as genuine increases as any others. They are reflecting the changed structure of our economy, the increased expenditure on services, an effect the importance of which we haven't adequately assessed as yet. It means, for instance, a reduction in the labour force that operates under collective bargaining as compared to the one that does not, because the proportion of those engaged in service occupations that are organized is on the whole lower than for processing in a factory.

However, I would agree with Mr. Bernstein, if that was the trend of his argument, that it is arbitrary to take, say, the consumers price index alone and, on the other hand, it is arbitrary to take the

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wholesale manufactured products price index, or any other single index. If I could trust government and if I could trust the professional statisticians and if I could trust, say, the central bankers, to hit upon the optimum blend, I would suggest that they take three or four or five indexes, watch them all; give them all the consideration that they judge to be appropriate and then use their judgment as to which of these to follow at any particular moment. In other words, there is needed a choice between a strict formula, which relieves both the person to whom you give the mandate and yourself of the need of further thought and the grant of discretionary authority, which means that personal temperament, inertia, the desire to avoid making difficult decisions over or under reaction to the flow of events may lead to an improperly operating control.

Here again I am avoiding a precise answer. This is apparently because I believe that precision is often the only virtue that precise answers have. I don't know any way of drawing a blueprint, whereby you can dispense with the need of wisdom, judgment, and information.

I would say now that if you want to rely tremendously on following indexes and choosing between them, the first thing you have got to know is your index, and you have to know it thoroughly. That costs money. You should not ask the ordinary statistical agency to do it as a routine thing. Unless Ottawa is very different from Washington, I would bet

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its appropriation would not permit it. You would need a special grant.

Secondly, there is something in having an outside survey of an inside operation, for there may be blind spots in the vision of the inside operator. For this and other reasons it is more beneficial to have a special outside survey made.

I would not answer the question even then, without additional information. I would ask the question, "What do you want a stable price level for?". You have to answer that first before you can answer which is the better of the two, a stable wholesale price level or a stable consumer price level.

In order to get a picture of the general structure I would put a good deal of weight on the consumer price index because I think that is where the inequities arise. In other words, people living on a fixed pension have to buy the consumer index basket of goods just as much as persons who are directly profiting from a wage inflation.

I would add this comment. If both indexes were good in technical quality in terms of the professional criteria of those who construct them, I would suppose that most of the time the range of difference would be relatively small, particularly for short-run trends.

COMMISSIONER GIBSON: Leaving off the question of the index, and I realize the problems you have mentioned, your philosophy, however, is that you regard stable prices as a proper and important

objective of national economic policy?

PROFESSOR VINER: I personally would recommend it as an important goal but "an" important goal and never "the" important goal. I would recognize situations in which I would let it go by the board.

COMMISSIONER GIBSON: Would you give more of your reasons why you think stable prices are important? You have given the sort of social and moral reasons. What about efficiency and the effect of changing prices and expectations?

PROFESSOR VINER: A stable price level does not relieve the operating public from the need of anticipating price changes, for the constituent prices will have shifting relations to each other. So that I am not arguing that a stable price level has the merit that it releases businessmen, say, from the necessity of speculating about price trends. They still have to speculate about price trends of the things they buy as against the things they manufacture them into, and so on.

Merely the expectation that prices will not be the same in the next year or ten years as they are now, without any knowledge as to the direction of change, this is not equivalent to a zero anticipation. It has as a consequence, for instance, that you might want to place some insurance against possible loss, even though you are not sure there will be loss. In other words, even if you had no net expectations as to what the price trend would be, but merely had the expectation that the prices will be different, there still are steps

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which it is logical and rational for you to take because of that expectation. So it has consequences.

I believe that forecasting a trend in a particular direction has an important consequence on the operations of an economy. There are circumstances in which the expectation that the price level is going to go up based on government influences, actions or promises, would be just what the doctor would prescribe. In 1931 or 1932 a pledge that the government would do everything in its power to see to it that prices within twelve months were 15 per cent on the average higher than they were at that moment conceivably could have been the step to produce the reversal of the deflationary trend, for a good deal of that depression resulted from an epidemic of fear, and one of the major fears was that prices would fall further.

The expectation of a declining trend of prices, particularly at a pretty severe rate, plus the assumption that wages would lag behind prices in the sense that they would not fall as rapidly as the fall in prices, could really be a very powerful muffler to business operations. The reaction it would create would be to reduce all inventory to the minimum, not to expand or replace productive facilities, and so on.

Actually, the old proposition that wages lag behind prices seems to be fairly dead now. The progress of collective bargaining has eliminated in part that objection to inflation; at least it has lessened it. Part of the injustice of inflation in the nineteenth century was that as prices rose it took quite a while

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before wages reacted to the full, so that for a while there was a reduction in real wages at least per hour of work.

COMMISSIONER GIBSON: Do you think there is anything inconsistent between a long-term, sustained increase of prices in what might be termed substantial proportions, and a reasonable efficiency in economic growth? You left me in some doubt because of what you have said about Latin America.

PROFESSOR VINER: Some economists report that they cannot see any close association between price stability and economic growth and, on the contrary, that they see some positive evidence of the opposite. I can give a partial answer; a complete answer I do not have. I am impressed by the authority and the standing of some of the men who have made this report in recent years.

The particular report that impressed me most, was by a very distinguished and brilliant economist de Scitowski of California, who found a positive association in time between even quite substantial inflation and fairly rapid economic growth.

The findings by themselves show that historically the two can be associated, and you must conclude that one is not an insuperable barrier to the other but they both might have been a common product of a third factor. It may also be that growth produces inflation rather than vice versa, and that you can have the growth without the inflation if you take steps to stop inflation. Nevertheless, I say, trying to be reasonably objective,

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the results are not to my taste, but there they are. They need further exploration but they do work against the strong conviction I had in the past that inflation and sustained substantial growth are incompatible with each other.

Do not misunderstand me. I am not going on record as recommending to the people of Canada that they practice inflation more than they have in the past, and even more skilfully and enthusiastically, or trying to assure them that their past inflation has not been responsible for a good deal of the troubles they tell me they are in now. All I am saying is that one fact which is often alleged by very conservative economists like myself is that history shows rising price levels and substantial growth to be incompatible with each other, does not seem to be true if compatibility is understood as meaning positive association in time.

COMMISSIONER GIBSON: Would it be fair to say that you would think this conclusion, which is only a negative conclusion --

PROFESSOR VINER: That is right.

COMMISSIONER GIBSON: You are not making a positive statement, but would that be more significant from the standpoint of Canada than the United States, bearing in mind that we are a raw material producing country, and so on?

PROFESSOR VINER: Well, a raw material producing and exporting country may have something substantial to gain from even chronic inflation <u>abroad</u> in the price of its prime export products. This may be

net gain, and net gain even though it results in inflation in its own internal price level. One must keep distinct the trend of the prices of, say, basic export products, in your own currency and in a foreign currency.

It would be a real question of policy if the prices of newsprint, pulpwood, copper, iron ore, raw lumber and other things, the basic commodities that Canada exports, are moving up in the outside world in terms of any currency you like, or in terms of gold -- as to what Canada should aim at with respect to its whole price level? My own feeling would be that, after giving a certain amount of weight to virtues I see in fixed exchange rates, Canada should still follow a stable price level policy of its own and take up these price premiums, if necessary, by exchange - appreciation of its currency.

The effect of a national stable - price-level policy on the export prices of Canada's products, I would say would be slight. Let us take the price of nickel. This is not settled by Canadian government policy or American government policy, or was not until a few years ago. It is settled by the world market, or, if you like, by a small group of men who decide what price is to their best advantage. It is, or was, a prize example of an administered price.

The price-level policy of a country, will for some time have an influence on the trend of its export prices in terms, of course, of its own currency, but often also in terms of foreign currency. There will

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The price-level policy of a country will for some time have an influence on the trend of its export prices in terms, of course, of its own currency, but often also in terms of foreign currency. There will

be some impact, and therefore a country following an inflationary price policy will for a time, perhaps, get higher real prices, I mean higher prices even in terms of foreign currency for its export product assuming either that it maintains fixed exchange rates, or that its prices rise more than the exchange-value of its currency depreciates. That, I take it, is an advantage in itself, but it may be associated with disadvantages. It may lessen the quantity of its exports seriously. In other words, the takings of its products may be immediately less, and it may always be susceptible to what is the great danger to a business, an industry, a country, an economy of upward price changes that they may initiate forces which might otherwise not have been started, tending to an adverse shift in the type of materials used, to a change in consumption patterns, in use patterns, or in processing patterns. In other words, there are dangers in relative price increases.

Let me take the price of nickel purely as a hypothetical illustration. In the years in which the price of nickel was clearly an administered price, it may be that the price set was too low in terms of the general Canadian interest. I am sure the producers followed their best judgment but their best judgment may not have been good or the price may have been too high. The danger of its being too low is only that instead of paying 20 per cent a year on the invested capital they would have paid 18 per cent, or 16 per cent, but the dangers of too high a price can be very serious in the long run not only to the producers but to

the national economy. It may not appreciably cut down sales immediately, but it may start people looking around for substitute materials for Canadian export products or for substitute sources of supply of the same materials.

COMMISSIONER GIBSON: Accepting the objective of stable prices, you mentioned earlier that due to collective bargaining wages tend to go up more or less in line with inflation.

PROFESSOR VINER: Yes. Again, there is this cost-push factor. It may even be the initiating factor.

COMMISSIONER GIBSON: Do you think, due to the fact that there is this cost-push factor in certain periods now, that a policy designed to achieve reasonably stable prices over a long period of time involves a wages policy as well?

PROFESSOR VINER: I would say certainly for the United States, and I would suppose that the Canadian situation is not different. It will not be possible in the future to have any genuine economic policy unless it includes some kind of influence on the pattern of behaviour of these two powerful forces, through mere consultation with them or otherwise. I am referring to those forces that can administer the prices of commodities and those forces that can control the rates paid for labour. Therefore, without some kind of an agreement as to the patterns of behavior reached in consultation, or by successful exhortation -- which is a method I used to ridicule as an instrument of statesmanship but which I now believe has some

potentialities in a mixed society and in a mixed economy such as we have, where power is diffused and where you do not want too tight or inflexible social arrangements, and where the "individuals" you are dealing with are not weak atoms but are in some degree "powers" rival to the power of government.

As in international relations, we are here clearly dealing not with atoms but with "powers". In such a case you need moral pressures and you also need education unless you are prepared, which I would hope not, to rely wholly on direct government controls. Education here ought to be tripartite. Government ought to assume its own education, and it ought to plead with the power - groups to educate themselves. If government does not have the education it means that the political process operates blindly. If business does not have it and if labour does not have it, it means that they do not want it; that they are biased against it.

I think you will have to look rather hard to find the most expert spokesmen of labour who are not inclined to find that the remedy for every kind of economic evil rests either in increases in wage rates or in a reduction of the working week without any reduction in the weekly pay, or in a combination of the two. Whether it be depression or inflation, they tend to have one specific remedy for all kinds of economic diseases.

On the part of business the chief difficulty is that it operates on the ideology of free competition but does not believe in it if it touches prices. Not

interests in a mixed society and in a mixed economy such as we have, where power is diffused and where you do not want too tight or inflexible social arrangements and where the "individuals" you are dealing with are not weak atoms but are in some degree 'powers' equal to the power of government.

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only does it not believe in genuine price competition, but it is actively at work trying to escape the pressures of price competition by arrangements which suppress it. The idea of price competition has been bred into the people of the Western world for all of two centuries, the idea that there is a kind of free economic system which operates to the benefit of mankind that produces progress and a reasonable amount of equity, and so on largely through the working of active competition.

Most of that argument immediately falls to the ground and becomes irrelevant if you assume that the competition is not in the area of prices. Because if it is in the area of salesmanship; if it is cost-raising competition as distinct from price-reducing competition; if it is, as it used to be in Canada in my boyhood, and maybe still is - the story is a different one. I remember that at many important cross-roads in Montreal there would be three little imitation Greek temples which were bank branches, and on the remaining corner there would be a saloon which perhaps did operate in perfect competition with the banks, but not with other saloons. There was no question at the banks of reducing the price charged to the customer, and no question of increasing the interest rate paid to depositors. Non-price competition which takes the form of product differentration which ~~is~~ not merely changing the colour of the product, although even colour variety is one of the blessings of life of the product differentration but the degree of blessing may be small -- is

by no means necessarily a zero or negative contribution to society. But, if the aim is merely to speed-up obsolescence,to make a thing wear out faster either in its physical capacity to last and to perform its function, or psychologically, as when a style change is introduced, when especially it takes the form of corrupting the public taste as in the case when automobile manufacturers went out looking for designers of more vulgar taste than their own who could really gauge the worst tendencies towards bad taste on the part of the public -- then business needs to be educated. I would let the small merchants do what they like. I would even let a small merchant cheat his customer; it will not destroy the customer. If he cheats his customer there will be a merchant on the next block who will profit by acquiring a reputation for honesty, and the cheating small merchant will voluntarily destroy himself.

Large-scale operators do not go into bankruptcy any more. Bankruptcy is nearly out for them. The modern large-scale business has a perpetual life. I say there should be a minimum of regulations, except for anti-trust regulations which should be carefully designed and reasonably but sternly imposed. Every government regulator in time, of course, tends to fall into the hands of the regulatee. That is true of the railroads and their regulations, and of T.V. and its regulations. There is a certain amount of supporting evidence for it and the regulations themselves can be worse than the ills they are designed to cure.

With respect to this question of cost-push or administered price inflation I have reluctantly come to the conclusion that the problem is possibly a serious one. There is a substantial amount of evidence that prices do sometimes rise when it is in the interest of the economy that they should not or even that they should drop, and that wages do rise even when it may be in the interests of labour, let alone the economy, that they should not. In order to operate your economy with a reasonable degree of efficiency the government may need to have the apparatus and the disposition to study and to come to conclusions as to what is desirable practice, and then to communicate its findings as firmly as it can to the public, and not demand but exhort those men with power to reflect on what these national objectives are, and on what the impacts of their own operations are, and then to act according to the dictates of their corporate consciences.

I think one of the great failures of the Western free world occurred when it allowed giant corporations to emerge without changing its own economic philosophy. Its own economic philosophy was a philosophy pertaining to small powerless individuals. When the giants emerge you need a philosophy and a policy appropriate for giants.

A corporation is just as moral as an individual -- more moral. A corporation will spend its shareholders' money on good causes when the directors themselves would not spend their own money on the same good causes. This is not so much a moral question,

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COMMISSIONER GIBSON: You are not thinking in terms of any particular formula, or anything of that kind, but rather to gradually develop a range of reasonable behaviour for these various groups?

PROFESSOR VINER: Let me take the American picture. They tell me the American economy is having its problems too. One reason is a sluggish rate of growth. Another one is an uncomfortable and nearly intolerable level of unemployment. We ought to do better than to have as many involuntary unemployed in the United States as we now have. Remember that the number of unemployed is generally greater than the number reported as unemployed. That is not necessarily true; if a husband loses his job his wife may then become a seeker of employment and be included on the labor force rolls, and then you have two unemployed whereas psychologically you have only one, so it may work the other way. But,a man who is unemployed and who does not think he has any chance of getting a job, may go off the unemployment rolls not because he is employed but because he is hopelessly unemployed.

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They tell me that the amount of unemployment in Canada is also too great. Able-bodied men able to work need an income, and the economy needs their production. If that situation persists for any length of time on a substantial scale, then the system is not working adequately.

In the United States we have also a balance of payments problem -- not in the sense of any deficit in our current account, but in the sense of a drain on our supply of internationally liquid assets. I think I know of at least 25 different steps which the United States could take, without revolutionary changes, to cure its balance of payments problem. This is one of the most minor major crises in the history of mankind. However, most of the steps would be unpleasant. Some of the steps would impair the image of the United States in terms of its international relations. They would have an adverse impact on the rest of the world. Some of them I would hate to recommend, although I would rather recommend them than have the government not do anything and have the trend continue.

The Canadian position may be different, and it may, in some respects, be weaker. I do not know it in detail, and I make no claim to speak as an informed person, although I may say that I know of nothing harder than to get a good interpretation of economic fact and opinion in Canada when you are not living in Canada. I assume it is available to all here every day at breakfast, but in the United States I find it is almost unattainable.

In any case, one of the areas of weakness in the United States balance of payments is that never in the history of mankind has there been such a manifestation of unilateral giving of one's substance to others without contractual obligations to do so.

The other one is what I would call promiscuously defending any area not only against aggression of a military kind, but also from its own people. We are defending everybody against everybody, except that we are not defending Russia against anything. Aside from that, we are defending Communist countries and socialist countries and anti-American countries, and there is no positive correlation between friendliness to the United States and American foreign aid.

There is apparently one easy path to correction of the American balance of payments deficit, and it is a path which many Congressmen would take with great enthusiasm. If they took it they would be cheered when they got off the plane in their own bailiwick. But they do not take this path. They keep enduring a kind of painful patriotism because they feel it is in the interests of the United States to stay with this pattern. They say it has a logic and a foundation in terms of the long-run performance of the United States as a leader of the world community.

These are the kinds of blocks that you meet when you are deciding policy. If somebody were to go among the operating economists in Washington and ask them: "What would you suggest for correcting our imbalance?" they could answer, "Give me an hour or a day and I will give you 20 different ways".

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I do not say each one would suffice, but when taken in combination they would more than suffice, but I would pray and beseech you in dealing with your own problem not to use most of them. One of the reasons is that the United States would be violating its treaty relationships.

Within limits we can always repeal treaties and when these are no longer appropriate they are subject to repeal. They are also subject to interpretation. Most of them are reciprocal in the sense that you are free to violate them but you will have to pay a penalty against which you must not protest.

You can, through moderate trade restrictions, temporarily cure most balance of payments difficulties. You may protest the long-run cost to your economy, or to your international relationships. You may be impairing a world structure of commercial relationships which may be in your long-run national interest. The economist who is aware of the complex setting in which the restrictive processes he is examining operate, and who is aware of how they operate, ought never to let himself be regarded as merely a plumber fixing a sink. He must always remember that he is concerned with the whole house. You may fix the sink and flood the cellar. The economist has to remember that.

Moreover, plumbing is not the whole house. If I were asked: "What specific recommendations would you make?" I would have to ask: "What do you want? What sort of a world do you want? What sort of a country do you want? What sort of an economy do you want?

Do you want something that will keep you going until Christmas or do you care about next year?", and other such questions.

My reactions to such questions will seem to most people to be sort of escapism and a denial that I have anything to contribute. I still think I have something to contribute, but I do not want you to think that I am professing to be able to give you advice as to what you should do tomorrow to take care of your problems. I would rather ask: "Do you know what your problems are? Do you know what their significance is in the short-term future, or in the long run? Do you know what kind of a country you want Canada to be, and do you know into what kind of world pattern you want to fit Canada?"

THE CHAIRMAN: We will adjourn for 15 minutes.

--- Short Recess.

THE CHAIRMAN: We shall now resume.

COMMISSIONER GIBSON: Professor Viner, you have ranged over a very broad field in an interesting way, and I would like to take up one of the comments you made just towards the end of your last statement. In assessing the balance of payments problems of the United States in particular, and talking about the relation of the balance of payments problem to economic policy, I take it you would not altogether agree with a statement that Lord Cobbold made to us the other day, which was to the effect that balance of payments pressures usually make you do the right things from the standpoint of monetary policy and economic policy.

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PROFESSOR VINER: Well, that is the old providential harmony argument on which I was brought up, and which I have often expounded.

COMMISSIONER GIBSON: He was speaking from the standpoint of his own experience.

PROFESSOR VINER: The balance of payments pressures which occur when you are having an inflationary boom probably are doing or are trying to do you good in almost every respect. But when your internal difficulties are severe, when you have unemployment and prices are soft rather than going up, it is unfortunate if at that time balance of payments pressures come along; I would not see any providential harmony in that situation.

So I would distinguish two classes of case. Historically, I would say there are times in which if by restrictive measures at home,statesmen met balance of payments pressure it would be very helpful.

I could name at least five or six Latin American countries at this moment where if the balance of payments pressures were taken seriously and almost any kind of deflationary response was made to them, it would be a good thing in terms of any reasonably sensible national goal. You may ask: Why are they so ignorant as not to respond in this way? It is not a case of ignorance, but of weakness and political selfishness on the part of those making decisions; they are pursuing short-run political goals. It is never pleasant for a statesman to tell the workman, "You must accept a lower wage over the next six months or year," or even,"You must not ask for an increase". That never

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brings great cheers for the statesman from the workman, though afterwards they can perhaps be persuaded that they ought to respect him for having done that.

So, in answer to Lord Cobbold's statement, as you have reported it, suppose you divide the historical record into two kinds of period, in one period there is pressure on the balance of payments associated with internal inflation, budgetary deficits and rising prices. Then, at least at the moment, I cannot imagine any form of deflationary response to the impact of that balance of payments pressure which would not be helpful to a sounder and healthier economy.

On the other hand, in a period when depression, falling prices, unemployment, and balance of payments deficit are present together, there is something tragic to face, the tragedy being you have two perfectly sensible, perfectly sound and quite important objectives that call for action in opposite directions.

COMMISSIONER GIBSON: Do you think this conflict in objectives could have been foreseen and perhaps anticipated?

PROFESSOR VINER: I suppose not. The only fairly reliable prophesy is that based on hindsight; that is a prophesy after the event. Even the "I-told-you-so" kind of reportis quite unreliable very often because the same man may have told you diverse things the week before or the week after, and is using the one that fits.

Again, I do not say you cannot do a certain kind of predicting. For instance, when things are easy

you can build up a certain amount of international reserves, in case certain kinds of events happen; reserves that can save you from severe pressures later and leave you freedom to cope with a domestic recession without having to worry about the balance of payments.

For a country like Canada, for the United States before 1933 and since, say, 1959, or thereabouts, and for all the rest of the world, the notion that there may be a balance of payments crisis in the offing ought always to be present in the inner consciousness of statesmen and government officials.

The United States lived in a peculiar period, peculiar to it and unique in history in general. It lived in the Fort Knox period. I gave a talk to the Canadian Political Science Association way back in the early thirties, in which I criticized the general feeling that the hoard of gold at Fort Knox was insignificant. I did not argue it was wise, but I did argue it had significance. I claimed that Fort Knox was operating powerfully all the time. How it was operating was to free the United States from certain responsibilities and obligations to its own people and its own economy which normally governments always had. It did not have to take into account the possibility of a balance of payments crisis. It had, in terms of visible proportions, an almost inexhaustible reserve in the form of gold at Fort Knox. In its policies it could therefore disregard balance of payments considerations; as it did from, I would say, 1933 to 1960 or 1961.

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COMMISSIONER MACKINTOSH: But other than that

could not?

PROFESSOR VINER: No other country could, and the United States itself normally could not. The special feature was that an outrageous devaluation produced an outrageous concentration of gold in the United States, and for one reason or another inflationary processes did not fully work themselves out, so that the gold did not get into the price level. But by 1959 the United States was again in the normal pattern, balance of payments considerations were again important for it; although it was two years before there was any reflection of the gold drain that I could see, in government policy; the reflection is not 100 per cent yet.

COMMISSIONER GIBSON: That is why I asked you if you thought this could have been foreseen. This problem was coming up for quite a while, was not it?

PROFESSOR VINER: I do not claim that I saw it coming before late in 1959, and I do not blame anyone for not foreseeing it. But in fat years one should build up reserves for the lean years even if one does not know when these lean years will come.

In the England of the nineteenth century, partly by design and partly by private profit motives, the Bank of England, historically the operating agency and the trustee of the gold system for the world, operated on a gold shoe-string, operated with a token supply of gold.

Throughout the century, from 1819 to 1914, this occasionally got England into very serious trouble, which could have been foreseen -- not in the timing,

but as a possibility. And the way to prepare for it was fairly readily available and known. Not that the Bank of England by itself could have done it, because it operated on a profit-making basis and it needed to earn dividends on it shares, and if it kept ample gold reserves there would have been no income. But the government with a formal or disguised subsidy, could easily have enabled the Bank of England to build up and retain a reserve, let us say, of 50 million pounds. We now regard that as a trifle; but it would have sufficed.

The United States has less freedom here than Canada has. The United States cannot protect its own liquidity very far without getting other countries into trouble, because it is too big and can augment its own liquidity only by impairing the liquidity of the rest of the world. Canada has unlimited scope in this regard. Canada can accumulate an adequate reserve without being conscience-stricken lest it be hurting the rest of the world if it chooses the appropriate time and Canada can afford it. The annual cost would be whatever the appropriate interest yield would be on whatever numbers of millions of dollars of international liquid assets would suffice for this purpose.

Moreover, I would point out that Canada has always known how to earn money on its international reserves, a thing not available to England. Reserves are not an income non-earning asset to England, but they can be and have been for Canada. Again, I would hate to be misinterpreted. I am not recommending to

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Canada now a free, irresponsible pursuit of liquidity in terms of narrowly-conceived national interest. Canada also has responsibilities with regard to the rest of the world. All I am saying is that they are not of the degree of those of the United States or of England -- and particularly of those of the United States. The United States is chosen to bear these responsibilities not because psychologically or morally or emotionally it is better equipped to carry them, but, again, because of its size. Size is of great consequence in the politics of international relations, as well as in its economics.

COMMISSIONER GIBSON: We are well aware of that here, in our relations, particularly with the States.

PROFESSOR VINER: One of the important ways of dealing with size is to get adjusted mentally, morally, emotionally and economically to one's real size. Its relative lack of size gives Canada a measure of freedom of choice as to the instruments to be used, say, to correct a balance of payments disequilibrium that is not open, in the same degree, to the United States because the United States would have very seriously to consider the impact on the outside world, and part of that outside world that the United States has to keep in mind -- and, possibly, does not keep adequately in mind -- is Canada. If the U.S. shrugs its shoulders that may be more than merely a jostle to its neighbour.

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COMMISSIONER GIBSON: I would like to

you a question or two about the objectives of relatively full employment. Would you care to put on record any range of numbers on that as to what is reasonable from the standpoint of American experience, say?

PROFESSOR VINER: No, I would not. I am not well enough informed to do so. A reported difference, of, say, between 2 per cent as a standard for one country and 4 per cent for another country might mean no real difference at all. There are important differences in definitions and in circumstances between countries. International comparisons of degrees of unemployment may mislead you more than they inform you, because the definitions are different.

COMMISSIONER GIBSON: How about accepting the American definition?

PROFESSOR VINER: I remember once sitting in on a conference at Washington when I was temporarily a civil servant, when the Agriculture Department was pressing for a definition of unemployment under which the farmer would be treated as unemployed from October to April. I asked "What about Babe Ruth? From all accounts he was unemployed for seven months of the year. What about a prima donna who sings only six times a year and yet gets $100,000" -- which was then a lot of money -- "and the rest of the time, apparently, is playing around?"

COMMISSIONER GIBSON: Do you not have a definition now that an unemployed person is one who is not working and is actively seeking work? Do you do this through your manpower survey?

PROFESSOR VINER: Yes, but "actively seeking work" is a highly technical term and means "if you are registering at an employment office", and there are many who would not register there even if they were on the edge of starvation. They feel it labels them, and so on. Also there are fakes. These percentages might be small, but as between countries the definitions vary, and if you are going to make comparisons of figures, what are you going to compare them with?

COMMISSIONER GIBSON: I think we have about the same definition here as you have in the States.

PROFESSOR VINER: The same definition can mean different things in two different settings. My own feeling is that in the United States anything approaching 4 per cent ought to be regarded as intolerable for more than a few months or half a year, or perhaps a year at the most.

I think that involuntary unemployment is a very serious evil. A working class that feels that other than transitional and frictional unemployment is a real risk is never going to feel that society is organized with due consideration of its interest. But I am not qualified to specify when in terms of unemployment statistics the signal for special action has been given.

COMMISSIONER GIBSON: So, when you get over this appropriate percentage this becomes a dominant objective of economic policy?

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critical percentage. When it comes to programs of action, moreover, I have no confidence in my own unaided judgment as to degree and timing.

If I were to sit with you gentlemen to plan Canadian policy, what I heard from you and learned from you, would undoubtedly influence any advice I would give as to kind, degree, and timing of action.

In this month of September, 1962, it may very well be that the important issue is price stability because it is threatened and there are to be considered measures which will support or weaken it.

Unemployment is not a major issue for any single week or month. Only as it continues for a period of some length should it be regarded as a major problem. We ought to know enough to be able to remove the risk of involuntary unemployment over a sustained period for the labour force as a whole.

150 years ago in England the major economic issue was whether it was possible to relieve starvation resulting from unemployment without undermining the honesty and will to work and integrity of the working class. Today we know that if you give the bare necessities of life to an unemployed man that it will not necessarily make him a bum for the rest of his life, but 150 years ago some of the fathers of our profession seemed to think that men could be so corrupted with ease. One of the great dangers is you have plural objectives -- that you need to be conscious of the potentiality of conflict between them and look for ways of adjustment so that you can try to pursue all your goals simultaneously

for periods of some length. But in any one week or month or even in one full year you may have to be working counter to one of these particular goals. But my feeling is that as far as unemployment is concerned, if it lasts for six months, and if in extent it crosses what in the wisdom of the experts is the tolerance level, you must do something about it.

COMMISSIONER GIBSON: Is there much difference between the objective of a reasonably rapid rate of economic growth and the objective of a reasonably high level of employment?

PROFESSOR VINER: It is important to distinguish those two, and when you are discussing one, not to assume that you are also discussing the other. It is obvious that an economy in which men are usefully employed all the time will, other things equal, grow more than one which has very serious unemployment. Employment does of itself produce a certain amount of growth. But the growth that people talk about now when they talk about national policy and unsatisfactory rates of growth is the per capita rate of growth at a normal level of employment. The rate of growth now so much under discussion is not a question of degree of employment or size of labor force but of rate of capital formation through saving from income, and also rate of technological improvement or increase of productivity per employed laborer.

The growth people are talking about now involves such things as comparing U.S. growth with Russian growth, aggregate or per capita, for its

military or political or prestige significance. Growth is also important for other reasons, such as, for example, its facilitation of adjustment without positive injury to anyone of shifts in products or in processes through the normal processes of retirement of workers and depreciation of plant. The modern emphasis on "growth" is concerned with contributions to growth by technical improvement or discovery and by increasing the ratio of saving and of capital investment to national income, and also perhaps by growth of labor force, but not with an upward trend of the ratio of employed to those wishing employment.

COMMISSIONER GIBSON: You said that growth was a long range structural concept of unemployment and that sort of range was more closely related to political requirements.

PROFESSOR VINER: Let me point out that what would at one historical stage be regarded as unemployment, perhaps serious unemployment, would be regarded in another society or historical stage as a healthy, normal, desirable situation.

The number of hours of a man's annual supply of hours that he devotes to gainful employment today is shrinking year by year in the western world. In the first place he stays in the educational stage before he enters employment longer than he used to.

In the second place, if he lives, he retires earlier. You have also the shrinking of the working week, the paid vacation, increases in the number of paid holidays, and all of these things are leading to

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an appreciable downward trend of the ratio of average working hours to the hours in a week or year, and this applies to the normal western country.

On the other hand, there are two forces working in the opposite direction; one is the increased proportion of the population that works at some stage of its life, especially the increased proportion of women that engage in gainful employment as compared to 100 or 50 years ago or 30 years ago, and the trend is quite marked. Another is that the shrinking of the official working week produces as a subsidiary phenomenon "moonlighting" or working each day on a second job.

Some of my professional colleagues believe it is dangerous to have growth objectives because that means that you are not going to accept whatever growth the free market spontaneously yields, but will introduce controls and directions and forced savings, and so on.

I have not raised the issue of freedom from regimentation; I will only say that at some stage I become quite sensitive to that sort of argument. Thought still has to be given and views have to be exchanged on this; the question is supposing that for a military reason it is decided that the American economy must grow at a faster rate per year -- whether in the aggregate or per capita -- how can you bring it about?

No matter what the purpose is, if you want that growth, the way in which the growth will be used matters. What service will be performed if all the

growth goes into more chrome on automobiles, for instance? My reaction to that is that no matter what special purposes you want to serve by the additional growth, you will not get it all for your purposes and you will have to take whatever is the more or less spontaneous proportion, whether you are to have more for education or hospitals or more for guns and ammunition. In other words, you can't design the allocation of the growth, and say that we must have 5 per cent in growth, all of which growth -- or 80 per cent of which -- must go to military purposes. You can't have that kind of regimentation in a free society; I don't believe even the Russians can achieve 100 per cent.

If you want growth even for military or education purposes you must strive for promiscuous growth in the hope that the required fraction of it will become available for the purposes that you really value. That is my answer to those who say that you must not accept this doctrine that the community has the right to decide what growth rate it wants, because it will involve giving up our freedom.

My answer to those who say you don't need growth to achieve your purpose, that all you need is to eliminate the trivial expenditures and use your resources instead for these other purposes, is that you will need a social revolution to produce this shift. Growth produces a promiscuous basket of things which people desire, some of which I approve of and some I don't. But we can't get for Jones the things we approve of his getting unless we also make it possible for him to get the things he wants but that we don't approve of.

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But I repeat that growth makes possible adjustment to shifts and changes in the economy, to changes in style, changes in method and processes, to shifts in foreign demand, exhaustion of particular kinds of basic materials, with much less human pain and loss, with much less friction in a growth industry. For military purposes growth may even be a handicap; there is a doctrine going back to the ancient Romans that wealth and luxury may impair military strength and ardour may soften people so that they ride instead of walk and can't endure austerity when needed, and so on, all of that may be weakening or strengthening. To me it has always seemed a little silly to compare our growth -- "our" being American now -- in gross national product with the Russian one as a military consideration without reference to the ratio of chrome to steel in the two product - mixes. A unit of Russia's G.N.P. may be worth three or four times in the military sense what an American unit is worth, and that may even be due to American prosperity rather than to poverty. In other words, it is conceivable -- that wealth may be, from a military point of view, a weakness, although if managed in accordance with the military objective as sole goal it would always be possible to make wealth build up military strength. If the United States was seriously concerned only about its military strength relative to Russia's, reconstruction of the pattern of consumption or the makeup of our Gross National Product would be a much quicker and better-aimed procedure in terms of hitting your target than would just working for general growth

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COMMISSIONER GIBSON: Professor Viner, this is very helpful and interesting. Unfortunately we have a great many questions to ask you, and I would like to go on to another general one. You have explored this question of objectives and conflicts between them in a most interesting and helpful way. I would like to ask you to give us your thinking a little more on the subject of the specific objectives of the central bank. You intimated in your submission, and you made it clearer in your spoken statement this morning, that you thought the objectives of the central bank should be much more limited than those broad economic objectives we have been talking about. I see you talk in your statement in terms of the primary objective. Could I ask you what that is? Is it stable prices or is it different things at different times.

PROFESSOR VINER: If I were designing the specifications which, say, the staff of a new central bank were preparing to submit to the government or to the Parliament for approval or for a mandate, I believe that probably I would advise the bank, while not leaving them totally out of contemplation, not to regard as its particular responsibility a whole, wide range of national objectives, and that it ask to be assigned one particular objective on which the government was agreed, and to be left free to pursue it except in a crisis. I would leave the general pattern of national objectives for the Parliament and the people and the political process to

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pursue through other agencies.

If you were then to ask me what is a sensible and suitable goal for a central bank, I would urge the traditional one of preserving the purchasing power of the national monetary unit.

COMMISSIONER GIBSON: That would be its primary objective?

PROFESSOR VINER: That would be its primary objective, but it would not mean that the bank says, "This is more important than anything else." The bank would say, "This is more important in terms of our operations than anything else for which we have special responsibility. If there are other things with which this conflicts, let the rest of the economy or the government accommodate itself to it and take whatever countervailing measures it wants to." The central bank should have the authority to do this and it should not have to face a minister of finance coming in and saying, "We told you we wanted a lower interest rate because of a new issue of bonds we are planning and what you have done instead is to produce a higher interest rate". If the central bank is set up properly the governor of the bank should, in these circumstances, be able to tell the minister of finance, in most polite terms, of course, to go somewhere or otherwise he cannot operate.

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PROFESSOR VINER: That would be its primary objective, but it would not mean that the bank says, "This is more important than anything else." The bank would say, "This is more important in terms of our operations than anything else for which we have special responsibility. If there are other things with which this conflicts, let the rest of the economy or the government accommodate itself to it and take whatever countervailing measures it wants to." The central bank should have the authority to do this and it should not have to face a minister of finance coming in and saying, "We told you we wanted a lower interest rate because of a new issue of bonds we are planning and what you have done instead is to produce a higher interest rate". If the central bank is set up properly the governor of the bank should, in these circumstances, be able to tell the minister of finance, in most polite terms, of course, to go somewhere or otherwise he cannot

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clarity as to what it can and should do, and cannot make a sensible selection of instruments or tools to use. It may be that you want to assign to the central bank as its major goal minimization of the cost to the government in terms of interest rate of its debt. To me that would be one of the most absurd national goals ever invented, but it is often the dominant goal of ministersof finance, particularly at issue time or a week before that. I say; keep the central bank out of that. Let us not confuse national objectives or the proper operations of a central bank by making the central bank merely the minor servant of the trivial goals of another agency of government.

COMMISSIONER GIBSON:: How do you decide whether the goals are trivial?

PROFESSOR VINER: It is a matter of dimension. How much difference does it make what the Canadian public debt costs in interest paid out by the Canadian government to Canadians, whether it costs -- I do not know what the range is -- $250 million or $255 million a year?

Another point is that the minister of finance may be trying to make some kind of a personal record. Gladstone, in order to be able to cut the income tax by half a per cent, would have, I think, lived on milk and water and punished himself and flagellated himself for months,and he would have thought he was thereby rendering a great service. But I am acting not out of character perhaps but out of the image I am trying to present when I use the word "trivial," because it

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is my thesis that it is always for the community to decide what the proper goals are. The economist is not a special expert on choosing as between national goals. In this particular case it is only because a very small quantity is something very much smaller than a huge quantity, that I presumed to use the adjective "trivial".

COMMISSIONER GIBSON: Suppose these differences persist over a period of time. How do you resolve it?

PROFESSOR VINER: It is not merely a question of whether it is a matter of major importance whether the interest rate on the average on the government debt is $4\frac{1}{2}$ per cent or 4-5/8. If the government thinks that <u>is</u> a major issue, then it ought to look around for other ways of dealing with that situation rather than through the central bank, for the central bank has other things to take account of. A law could be passed that every man with an income of over $5,000 a year shall buy a prescribed amount of long-term government bonds until the rate of yield of government bonds falls below some forbidden rate.

Or some other ways of doing it without interfering with the central banking process should be adopted. I stress non-interference with the central banking process, however, only if it has clearly assigned and narrow goals and sticks to them; otherwise you are making the bank the authority over the economy and I am not advocating that.

COMMISSIONER GIBSON: What you are emphasizing

[illegible]

decide what the proper goals are. The economist is not a special expert on choosing as between national goals. In this particular case it is only because a very small quantity is something very much smaller than a huge quantity, that I presumed to use the adjective "trivial".

COMMISSIONER GIBSON: Suppose these differences persist over a period of time. How do you resolve it?

PROFESSOR VINER: It is not merely a question of whether it is a matter of major importance whether the interest rate on the average on the government debt is 4½ per cent or 4-5/8. If the government thinks that is a major issue, then it ought to look around for other ways of dealing with that situation rather than through the central bank, for the central bank has other things to take account of. A law could be passed that every man with an income of over $5,000 a year shall buy a prescribed amount of long-term government bonds until the rate of yield of government bonds falls below some forbidden rate.

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PROFESSOR VINER: A clear mandate; partly because I think the central bank will operate more efficiently if it has a clear mandate, and partly because I think the central bank will have a great deal more courage to follow its goals as it sees them if it has a clear mandate to support them and can plead not merely its own wisdom as to selection of goals but the mandate that the people has assigned to it.

I think that is important in the United States. You have the advantage in your mandate, as I read it, that your central bank is given as one of its goals the maintenance of the purchasing power of the Canadian dollar. We do not have that in the United States.

COMMISSIONER GIBSON: The central bank, in setting down goals, has included most of these other general objectives.

PROFESSOR VINER: I think I said I would have the central bank act rather conservatively as to the number of goals it recognizes as coming within its field of responsibility.

COMMISSIONER GIBSON: Do you know of any central bank that has a simple, clear-cut goal of the kind you are talking about?

PROFESSOR VINER: You mean that has only one?

COMMISSIONER GIBSON: Yes, in fact.

PROFESSOR VINER: I do not know of any central bank that has been formally assigned a logical function in its own economy. The central banks are still emerging, still changing. They have a relatively

short history, and a lot of that history is a history of adherence to traditional ruts.

I am trying to make only one point; that it is important that the central bank be assigned specific and clearly defined duties. What these duties should be is a matter for national decision.

If you ask me what are the professed goals of most central bankers, I would say that if they were appearing before a gathering like this they would include a wide range of goals, including virtue and motherhood and also everything else they could think of which is nice and good.

COMMISSIONER GIBSON: We had Dr. Holtrop, the Governor of the Netherlands bank, give evidence. He made it quite clear that their primary goal is stable prices.

PROFESSOR VINER: That may very well be. But a central banker, when his bank has been doing very well on stabilizing prices, will naturally speak that way, but the same central banker, when the record of his bank over the past two or three years has not been too good, as far as price stabilization is concerned, will be likely to start talking about other objectives. I believe strongly in the importance of a clear mandate to the central bank. Some years ago, testifying before a Congressional committee in Washington, I urged that a price stabilization mandate be made part of the Employment Act. Literally, as I read it, the Employment Act is a plea for maximum inflation. It asks for maximum "purchasing power" and does not define it, and the most obvious definition of that is: the

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maximum amount of money possible. Now, that depends only on the speed of the printing press. I was rather severely attacked by Federal Reserve economists at the hearing on the ground, of course, that price stabilization is implied and included in the mandate to the Federal Reserve and has always been taken into account. My colleagues in the profession also thought I was minimizing the extent to which by the nature of things the central bank would already assume that to be its mandate.

The next thing they criticized me for was my assumption that if a central bank did have a mandate it would make any difference, that the words would have any effect. I may still be wrong, but I now have the satisfaction that the administration, the same committee of Congress, and the Federal Reserve Board itself, have since come around to the idea that there is some virtue in an explicit mandate to promote price stabilization, and they think they need it in their business, and for the reasons which I had expressed, even if clumsily.

I will tell you how I came to the conclusion I did, as it may be relevant. I was at one time adviser to the Secretary of the Treasury. The Treasury Department in Washington had a tremendous range of functions spreading all over the map, and I had contact with a number of them. I found the Customs Bureau was a case in point. On the question of interpretation of tariff rules, an important diplomatic issue arose with Nazi Germany as to duties. The issue came up as to whether a certain item in the statutes gave mandatory or discretionary power. The State Department -- and the

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business of the State Department is to keep the peace and at that moment its business was to keep the peace with the Nazis -- fought hard on behalf of the German government on the ground that the statutory provision although written in mandatory form was really discretionary, and that the Secretary of the Treasury could use his judgment in the interests of peace, or prosperity, and so on. The Secretary was able to reply honestly to the State Department and to the President that his general counsel and the Director of the Customs Bureau, who was himself a lawyer, had said that it would be an impeachable act to disregard the letter of the statute, and that the mandate was explicit and clear. I saw on a number of occasions a powerful secretary of the treasury in close contact with and with great influence on the President, and having the President's support, finding it impossible psychologically to take some desired step against the position of his own legal staff that it would be counter to the statutory mandate under which he was operating.

Now, I might put the other phase of it. There are in Congress certain men who hate the mere idea of restrictive monetary control, and who apparently consider that money does not show its full potential virtue unless it flows in unrestrained abundance. There is obviously some kind of a conflict between that kind of legislator and a central bank.

In a case like that my own inclination would be to defend the bank against the legislator and the best defense is that the parliament or the legislature should disarm that legislator by passing a resolution

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or giving a mandate authorizing the central bank, without asking this statesman whether he likes it or not, to go on doing a specific job that Congress or the parliament or the legislature had assigned to it.

Your form of government is different from ours, but I believe is sufficiently like ours in needing to sort out the functions and to assign duties to appropriate agencies. This is in no way inconsistent in a democracy with the ultimate force and power of government resting with the government and not with any delegated or appointed agency even if it involves some restraint on the part of the executive branch of government.

COMMISSIONER GIBSON: Thank you, sir. Perhaps some of the other Commissioners would like to ask you some questions on this subject.

COMMISSIONER MACKINTOSH: I would like to ask one question. I was a little disturbed by what was perhaps a wrong inference from what you said earlier in arguing for a clear mandate for the central bank, and, in some degree,a disregard, or an ability to disregard, government policies of a different sort. Surely, if a government wants to do certain things in terms of fuller employment and the central bank is intent on a stable price level, it is better for them not to act at arms' length and in closed rooms, but to discuss the inter-relationships and arrive at effective methods of operating so that both objectives can be achieved as nearly as possible in the circumstances.

PROFESSOR VINER: I certainly agree with

what you said, and agree enthusiastically. I would, perhaps, elaborate, and without contradicting what I said before because I was speaking rather metaphorically. Remember that I did make an exception with respect to a "crisis", and then I changed it to "emergency".

Let me try to explain again what I regard as one possible way of setting up a central bank, limiting its functions, and also giving it a clear mandate. Perhaps the government itself might want to change its mind about that mandate so I do not say that the bank should have the power of veto, or that it should have an unbreakable contract as to the tenure or length of time during which the mandate it has shall be effective. In terms of governmental organization in relation to the central bank, or the relationship of the central bank to the government, there is an infinite number of ways which the arrangements can take. One thing I would stress is that the government is the final authority and not the central bank in a full-fledged democracy. That is an element of democratic principle. The government cannot surrender its own authority beyond a period of time unless it loses its sovereignty. I would not, for instance, wish the sovereignty of the Dominion of Canada to be shared with the Bank of Canada. I would keep it in the government of Canada, and so would I with respect to the United States.

But, this mandate may be a self-denying ordinance on the part of the Cabinet, or the Congress. To speak in American terms, when Congress passes a resolution or an act it imposes an obligation not only

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But, the mandate may be a self-denying ordinance on the part of the Cabinet, or the Congress. To speak in American terms, when Congress passes a resolution or an act it imposes an obligation not only

on the federal reserve but on itself. That is something that generally Congress is emotionally unwilling to recognize, namely, that when it passes an act it is operating as a restraint upon itself for a week, at least, or a month. In practice administrative agencies in Washington continually have to complain that Congress gives them instructions in January and then in February a Senate committee scolds them for having carried them out. I recognize that absolute precision of mandate is impossible in practice, that some degree of elasticity is both inevitable and desirable, and that since it is human beings that are involved, you have to work that out in terms of personal relationships, and not by precise formula.

Let us suppose that unemployment is the issue on the one hand, and that stable prices is the issue on the other. If the most promising avenue of approach to an unemployment problem is, say, a budgetary deficit financed by the central bank, then I would say it would be better to arrange it so that it is not financed directly and compulsorily by the central bank because that impairs the ability of the central bank to carry out its own responsibilities.

Let us suppose instead that the government's financing is done by way of short term bills which are sold to the commercial banks. In a situation of that sort I would not have the central bank rushing in to impose tight money, on the ground that otherwise the effect of that bill flotation is going to be that next season, or next year, prices will rise. I say

let the Bank in such circumstances see the whites of inflation's eyes before it starts shooting.

COMMISSIONER LEMAN: Professor Viner, would you not feel that the danger of these kinds of resolutions could become fixations? Can I use an example relative to United States? There has been great discussion about long-term government bond interest rate ceiling in the United States. That was a kind of a law and resolution that became so firmly engrained that it is fairly difficult to do anything about it. Is not that so?

PROFESSOR VINER: But notice whose infatuation that was. It was an infatuation of Congress and not an infatuation of the central bank or of the Treasury. There is no cure for that. I propose no remedy. I am enough of a democrat to say that Congressional infatuations for the most part have to be accepted as acts of God. There is nothing you can do about them. But, I am thinking in the realm of the do-able. On the whole I have no general presumption that the administrators and the executives do not have their own infatuations as well as Congress -- and even economists.

When you started I thought you were going to ask me: What if the central bank has an infatuation about a certain device, or a certain rate, or a certain level of prices, or a certain cyclical pattern? History is certainly as marked by infatuations on the part of central banks as on the part of Congress. Central banks have a more stable tradition, whereas

Congress changes every two or four years, and it changes with the parties, so that Congress has a greater range in variety of infatuations. But, central banks have traditional rigidities, some of which may even be very good on the whole, but none of which, because they are rigidities stretching over a long period, could have been equally adaptable to the desires and wishes of different countries or of the same country at different times.

In the case of one possible rigidity that I am proposing -- this mandate of the central bank which authorizes it within limits to do whatever in its judgment is necessary within those limits, so that long-run forecasting is left out of the picture -- in order to remedy a current instability of the price level or something like that, the central bank might fall into an unsuitable rigidity. In such a case Dr. Mackintosh's terms might become very relevant. But remember that there is a remedy on hand. The same power that gave it the mandate can withdraw it in a crisis.

I would like to be permitted to make a kind of a suggestion as to how to deal with a situation of conflict of purpose or objective, or as between blindness in the vision of one agency as against blindness in the vision of another agency as to what is important. I believe in the high level conference for the exchange of information, and views. From the proper level of power and authority, what ever it may be according to the country and its system, if agreement has not

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been reached or an understanding has not been reached, there should come a change in the mandate. That should come from the highest authority, whatever it may be. With it should come a clear announcement to the public that the issue has occurred, so that the whole matter never becomes a backroom matter. The public must be aware of the fact that there is an issue, that there is a conflict of position, that it involves a conflict of goals,and that high authority has decided the issue. In that way you maintain the prestige of the agency that has been shoved aside on that. At least, it has not yielded through timidity; it has yielded to legitimate authority, and it is now carrying out a new mandate which is made perfectly respectable by the fact that it has been decreed by the supreme authority, even if nothing else can be said for it.

If a statutory or executive mandate runs counter to all the ideas of the federal reserve as to what is a respectable monetary policy then maybe they ought to resign as a moral protest, but apart from that crisis of conflict of opinion I think what I have suggested is a workable type of procedure. But the decision must be announced in detail so that the public, and the legislative body also, has a chance of deciding on the merits of the issue, and so that this is not merely an ad hoc casual interference but is a thoughtful and considered procedure on the part of the government.

COMMISSIONER MACKINTOSH: It seems to be implicit in what you are saying that the mandate comes from the government in power, and not from the legislature.

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COMMISSIONER MACKINTOSH: It seems to be implicit in what you are saying that the mandate come from the government in power, and not from the le

PROFESSOR VINER: Well, you know, that would be a matter that would vary from country to country. I do not make an issue of whether it is the Executive branch or the legislature which formulates or decrees any mandate.

In England, where party discipline is perfect and parliamentary government in the British sense is complete, the decisions are made by the Cabinet although perhaps confirmed by Parliament. As I am not inside the Cabinet I do not know what a "Cabinet decision" means. Those decisions may be made by the prime minister for all I know. Your question would not be, in the normal sense, relevant for England. In England it is a violent protest which sometimes disturbs the placidity of the government when 25 or so back-bench members of the prevailing party speak mildly against a government-sponsored measure, even if when the division comes they usually vote for the measure.

The American picture is quite different, and I do not know the Canadian picture. I have lost track of just how Canada is governed. However, the American picture is not like that at all. If you ask me who decides then I will say it is a gamble as between any number of agencies and branches. Congress has within it scattered pockets of power. It has imperialists and absolute monarchs scattered all over it as far as specific items of policy are concerned. Power is broken up into little packages. There are at least a hundred men in Washington who are on some type of issue liable to have the absolute power of veto such as is

found in the Security Council of the United Nations. It may be the chairman of a sub-committee of a committee of the house, and to all intents and purposes ---

COMMISSIONER MACKINTOSH: I am not concerned with the ultimate sources of power, but whether or not this is a mandate which can be changed quickly, and at all or any season of the year, or whether it is a piece of legislation that you can get around to in the course of a session.

PROFESSOR VINER: The issue that your question raises, as I see it -- and it is an important and real

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issue -- is: Do you want the instructions or guidance to the department to be in the form of an act of parliament in rigid terms or do you want it in the form of an authorization from parliament to the prime minister to tell the government of Canada what to do at any time of the day or night by means of just a telephone call? There are your two extreme limits. Another question appropriate to that would be: If it is a parliamentary mandate what do you do in what I call emergency circumstances?

What I suggest is a calling together of the powers that be, the conflicting agencies -- and in the Canadian pattern that means the Cabinet -- and the thrashing out of a decision which would be authoritative. That can be done within 24 hours. There is that flexibility plus -- and this I stress very much -- a really revealing announcement to the public. Do you need more flexibility than that?

COMMISSIONER MACKINTOSH: No, no.

PROFESSOR VINER: In the United States the problem is much more difficult because there is no machinery which in the highest emergency is guaranteed to be able to concentrate power quickly in any one sphere. In the United States your question would be a much more troublesome one. That is a tribute I pay to the British form of organization. I think for purposes such as these, at least, it is a much more logical form, and has much more potentiality of efficient operation than has the American form which can at times produce near chaos.

COMMISSIONER MACKINTOSH: We have had some

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discussion about the practice of some governments issuing directives to the central bank. These seem to have been acts of last resort. You imply, I think, that the central bank would always have a directive from the government, or a mandate as you call it, and it would be a publicly announced mandate which would run until it was changed.

PROFESSOR VINER: Yes, but I have a kind of temporary and qualified discretionary facility within limits within the Bank which could be incorporated into the original act so that it is consistent with the act. But, remember, the essence of what I am recommending is two things. One is, if you like, a council of war, or a major council of government, meeting to change the mandate to the agency, and the second is complete publicity, explanation and justification. That justification can be directed to both the legislative body and to the people. Those are the two major steps.

As I understand democratic process, there is a necessity to have the formal council called. That is part of the formality or the ceremony. Secondly, there is the obligation imposed by the statute -- or by tradition -- that there shall be full disclosure of the reasons and the purposes of the action, to the legislature, the public, and the agency, so that the dignity of the

discussion about the practice of some governments issuing directives to the central bank. These seem to have been acts of last resort. You imply, I think, that the central bank would always have a directive from the government, or a mandate as you call it, and it would be a publicly announced mandate which would run until it was changed.

PROFESSOR VINER: Yes, but I have a kind of temporary and qualified discretionary facility within limits within the Bank which could be incorporated into the original act so that it is consistent with the act. But, remember, the essence of what I am recommending is two things. One is, if you like, a council of war, or a major council of government, meeting to change the mandate to the agency, and the second is complete publicity, explanation and justification. That justification can be directed to both the legislative body and to the people. These are the two major steps.

As I understand democratic process, there is a necessity to have the formal council called. That is part of the formality or the ceremony. Secondly, there is the obligation imposed by the statute -- or by tradition -- that there should be full disclosure of the reasons and the purposes of the action, to the legislature, the public, and the agency, so that the dignity of the

agency is protected, and so that it is not done merely by a message over the telephone from some official. It is done formally in writing after the council meeting.

There is a particular country in Latin America where the president can phone the governor of the bank and say, "We need 500 million more of currency and start issuing it at once, and lend it to these particular agencies." That can be done over the phone without consulting his cabinet, and the legislature need not know about it, and there need be no public announcement. That is one way. But it makes a mere clerk out of the Central Bank

I do not know that anybody has ever advocated that relationship for a central bank. I do believe that some prime minister have made gestures towards operating that way, but they never would have made it as a general statement to their people, as to what proper practice or policy is. On the other hand, I do not recommend a central bank so rigid that it goes ahead following a path prescribed to it, or self-prescribed, even if the heavens fall; there should be some orderly way in such circumstances of cutting a central bank down to scale. In the light of history both are concrete possibilities -- I speak here not with respect to Canada, but to the world of central banking at large. Interference with the autonomy of a bank in its day-to-day operations and in the use of its judgments in the selection of the goals it is pursuing, ought not to be casual and undisciplined, and even a president of the United States or a prime minister needs to recognize that in the proper working of a democracy even the highest executive authority needs self-discipline or even external discipline.

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I suppose, in practice, it is certain that a perfect procedure will not be completely attainable, but the ideal one seems to be one that preserves in general the ability of a central bank to perform its assigned functions as it sees fit under its mandate, and yet to take from it ability to wreck the nation by misguided or unwise or too-rigid pursuit of its objectives. Take away from it the power to destroy the economy, but leave it with the power to render the maximum service of which that kind of agency is possible. The bridge I build between these two is to impose a code of behaviour on the top authority which is, in general, self-denying and non-interfering, but which permits in an emergency direct interference subject to a substantial measure of solemn ritual. The agency must be heard; and that council must hear the agency before it reaches its decision.

Secondly, the decision must be in writing so that the agency is protected in its professional self-respect by being permitted to show that it is obeying higher authority and not changing its own opinions.

Thirdly, the legislature and people must have a chance to comment on it, and either to commend

or condemn the intervening authority.

COMMISSIONER GIBSON: You are not recommending a detailed mandate to a central bank on not only what its principal objectives are, but how it carries them out? You want a general objective and only specific interference where it is necessary?

PROFESSOR VINER: I think I would add to that a listing of the instruments that it shall have the authority to use, because some of these instruments may interfere with the rights of subjects and citizens. It needs legal authority to do that.

Also, if it intends something new and that involves interference -- let us suppose it wants to change the pattern of figuring reserve requirements. To the banking system that may be something of the utmost importance. The central bank ought not to be able, over night, because somebody on the staff had a brilliant idea, to change the whole pattern of reserve requirements and the way of figuring it. That mandate should outline the powers the bank is to have.

If the central bank becomes convinced that, after all, the pattern of reserve requirements it is using is antiquated and is not geared well to meet the usual purposes, I would have easy access of the central bank to whatever machinery there is for initiating new legislation -- subject of course, to the consent of the government.

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I am not saying that the mandate ought to include the provision that the central bank must never acquire a new idea and put it into practice. But legislation, in some cases, will be necessary, where the effect may not be substantial from the point of view of the economy as a whole, but may be very important to a particular sector of the economy; I am just following the general idea of democratic process that the situation of an individual or a firm or a business before the law shall be clear to it and shall not be changeable except by due process. What is to be regarded as "due process" will vary as between countries and circumstances.

THE CHAIRMAN: We will now adjourn until 2 o'clock.

--- Luncheon Adjournment.

--- On resuming at 2.05 o'clock.

COMMISSIONER BRONW: This morning we had a very full and interesting discussion on the objectives and their various conflicts, and I wonder if we might discuss now the means of reaching these objectives of economic policy, with particular reference to the effectiveness of monetary policy in achieving these and something about the mix between monetary policy, fiscal policy, debt management, exchange policy, without at this stage going into the detailed techniques of monetary policy and, in that connection, perhaps you could give us your opinion as to which of the objectives, if any, you consider monetary policy most effective at achieving.

We discussed at some length the setting of single objective for your central bank, and you picked on one; was this because you considered this the one on which monetary policy had the most effect or otherwise, if you follow the range within which we would like to discuss this next section.

PROFESSOR VINER: Well, I think that probably the potentialities for substantial achieving of a goal for monetary policy are greatest if the goal is a decision on the price level. In its chances of success -- of all the possible goals that might be assigned to it -- it would be rivalled and perhaps closely rivalled -- I am talking about potentialities and not historical achievements -- by the ironing b out or moderating of cyclical fluctuations, which means substantially the achievement of the full

employment goal. As far as unemployment is concerned, it is mostly cyclical:

I abstract from frictional unemployment, as not appropriately to be made a major concern for a central bank. Seasonal growth I would like to abstract from too. It might not be worthwhile doing much about it in a country like the United States or Canada, although in a country in which they have, let us say, a three months' growing season, and which is predominantly agricultural, and for the rest of the nine months there is nothing much to do, it can be a major problem, but that is not the case any more here or in the United States.

In any case, it seems clear that you can't deal with seasonal fluctuations to an important degree through monetary policy, once you have solved the problem that existed in the United States, and perhaps in no other country, that before the foundation of the Federal Reserve Bank there was such a rigidity in the mechanism for issuing currency that there was great seasonal inelasticity in the currencies. All it needed was a minor re-designing of the banking system to cure this.

I abstract also, for the time being, from chronic unemployment resulting from collective bargaining or administered prices. That leaves me with cyclical unemployment and here monetary policy I think is potentially capable of doing a great deal.

I believe that at this still experimental stage we ought to try not to put reliance solely on

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I believe that at this still experimental stage we ought to try not to put reliance solely on

monetary policy but work also through fiscal policy. In the field of fiscal policy some important discoveries have already been made and they are very gratifying; chief of these is that you can have built-in stabilizers in your fiscal system and that they work with much more success than had been anticipated. Their record already has been surprisingly good. I speak of the American experience; on the Canadian experience I am not informed.

COMMISSIONER BROWN: And that is towards the objective in connection with unemployment?

PROFESSOR VINER: Yes, that objective of cyclical unemployment and that doesn't conflict -- I speak offhand, -- with any other objective that I know of, because ironing out the cycle is good for price stability, is good for growth, it is good for the unemployment problem and is also good from the point of view of social justice and of other considerations.

I am relying on a ten or fifteen year record; maybe next year I will be eating my words, maybe we haven't really solved the problem, but on the record since 1946, since the end of the war, the cycles in your country, in England, in the United States, have been milder, have been shorter. So far there seems to have been a structural change in the semi-spontaneous working of a capitalistic free enterprise system which lessens the menace of the business cycle, and that is a great step forward.

Now, monetary policy undoubtedly has an important role in moderating the process of working towards long-run stabilization of the price level/and is

in large part identical with the process of lessening the cyclical instability of the price level.

If the outsider may judge from the record of past experience, central banking seems to be inherently susceptible to internal weaknesses to which it needs alerting. On the bare record of its operations, it would sometimes be difficult to find persuasive evidence that moderating rather than amplifying the cycle was its goal, especially if one correlates cycles in prices with cycles in money-supply and assumes that central banks if they can control anything it is the money-supply. There is considerable evidence that central bankers have upon occasion been fearful of using their instruments of control because they were believed to be so powerful as to be too dangerous to use and upon occasion, sometimes the same occasion, have spoken somewhat contemptuously of their instruments as being so feeble as not to be worth invoking. There have also been instances where action was taken, and in the right direction, but the action taken was disproportionate in degree to the action needed if full stabilization was aimed at.

The past record shows that many remedies have been proposed for various kinds of monetary ills in the past; the skeptic says that they have never succeeded in the past, the optimist replies that they never have been seriously tried.

COMMISSIONER GIBSON: Is there a possible conflict between stability of prices and ironing out cyclical fluctuations?

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CONSISTENCY CRITERION. Is there a possible conflict between stability of prices and lending

PROFESSOR VINER: I don't see any glaring one; I see some possibility of conflict, but obviously if the stability of prices which you are aiming at is defined in terms of trying to make the price level exactly the same each hour as it was an hour before, then I say there is a big conflict between anti-cyclical stabilization and price stabilization, because using the central bank's instruments for anti-cyclical stabilization means that in that sense of the term you are working deliberately to alter the price level of the movement. I would regard anti-cyclical stabilization of prices to mean taking the cyclical peaks and aiming at reducing the deviations in each cycle from its peak level to a minimum.

Now, in that sense you are sometimes working to increase or to lower prices -- I mean, the central bank is working to change prices rather than to keep them from changing.

COMMISSIONER BROWN: The two are inharmonious.

PROFESSOR VINER: They are in that definition, but I am not interested in stabilizing prices regardless of the cyclical circumstances. I don't necessarily want the prices to be today the same as yesterday; I may want them to be lower or higher. If yesterday saw an undesired depreciation in price, I would welcome its being higher today if I were a central banker and I would do something to make it that.

In other words, the price stabilization with respect to the cycle that I would want the central bank to pursue is a horizontal long-line trend, which

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is a horizontal line and minimum cyclical deviation from that horizontal line. If the actual price trend does deviate a lot within the cycle, then the central bank should work to change prices rather than to keep them at the level the other forces would make them be if these other forces were not countervailed by the bank. You may not want to call that price stabilization, but it is what I mean by the term "stabilization of a cyclical kind." It means that you want to minimize the deviations within the cycle,from the long-line trend and to minimize them you sometimes want to change prices from what they were yesterday; raising them if they were below the trend and lowering them if they were above the trend.

COMMISSIONER BROWN: But when the level of unemployment comes into the cyclical trend, can't there be -- as Mr. Gibson suggests -- quite definite periods when these two things are in conflict as far as your monetary policy is concerned?

PROFESSOR VINER: You mean anti-cyclical stabilization would be in conflict with employment stabilization?

COMMISSIONER BROWN: He didn't suggest it; he asked if there will not be periods when this might occur.

PROFESSOR VINER: I would say on general principle, yes. In practice can I find important conflicts? Well, I would yield to others who have more knowledge on whether such major conflicts are likely to occur. I can certainly conceive of cases

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and I can conceive of the possibility that they may be very serious ones. In any event, there is a factor, the administered prices and the cash-push factor which can generate such conflicts. Here you can have any combination of conflicting objectives you like. If prices are being pushed up, say, by a powerful labour union and the employers say to government, as they may very well say at this moment in the United States to the government, "If you want us to yield to these labour pressures we will yield but we will raise our prices", the government is quite likely to accept price - instability in the interest of employment stability.

Let us assume that at the time we are on an inflationary trend and prices have been going up anyway. Now, the government for whatever reason it wants to support labour, and wants also to make it possible for the employers to maintain employment despite the rise in wage rates, therefore retreats from its price stabilization goal. There is a case of conflict. What could the central bank do in a case of that sort? I would tell them to go out for a walk. If there are administrative prices; if there are cost-push factors, and if there is/also chronic unemployment -- there is always an argument against doing something which would tend to aggravate the unemployment. Under these circumstances, a central bank has no instruments appropriate to the situation, and should firmly deposit the problem on the government's lap.

COMMISSIONER BROWN: The central bank under those circumstances loses its effectiveness.

PROFESSOR VINER: It loses its function. What would then be its function? It would not then be to stabilize prices, because in effect the government has decided that prices should be allowed to ride.

COMMISSIONER GIBSON: We have had the suggestion put to us that it is between these two objectives; that if too much emphasis is put on monetary measure for recovery, you may push so much potential liquidity into the economy that you have an inflationary problem which carries into the future.

PROFESSOR VINER: I am familiar with the argument. It is a "lag" argument, an argument resting on the belief that the full effects of a monetary action come only after a fairly long interval.

I am not impressed with that argument provided the central bank feels perfectly free to reverse its action at any moment.

I do not think that injection of a certain amount of currency or tremendous bill purchases by the central bank today need have any unwanted effect on the price level two years later, if you leave to the bank power in the interval to reverse its action to any degree it regards as appropriate.

If I were a central bank operator I would rely on the first impacts of my action and on the power to reverse these actions as soon as they were causing more price-rise, or price-fall, than was desired. Liquidity is sometimes treated as if it is injected into or withdrawn from an economy with its effects delayed for up to two years or more. I do not believe

that the process of monetary control need be operated in this manner. I would have central banking rely mainly on the first impacts of its operations, with full flexibility in reversing its actions whenever they appeared to be having more effect than was desired. Inflation normally requires the support of an increased money supply to sustain itself and deflation normally will cease if the economy is given abundant liquidity. A central bank which has the power to change the money supply has the power to control the general trend of prices, without need of resort to forecasting, if it is willing to use its instruments with sufficient flexibility and reversibility of direction.

Many central bankers have the notion, and other people have the same thought, that the ideal central banking mode of operation is to be quiet and passive most of the time, and especially not to be continually active. I feel that the central bank is very much like -- and I am not an expert in these matters -- the driver of an automobile on a very difficult mountain road. He is operating all the time, but he has to reverse himself as he goes along. He is braking part of the time and at other times he has his foot on the accelerator. That is the way I would work as a central banker. I would be feeling the pulse all the time. I would be moving, but moving in small degrees, not because there is any virtue in smallness, and not because I would be afraid of substantial action but because frequent change of degree and direction would be called for. If you are

operating frequently, your particular moves need not be large ones. They can be cumulative if need be. Further, the central banker should do no forecasting, but should operate in terms of approval or disapproval of the trend of the immediately preceding period. If you like the way the period has been moving, in direction and degree, go on as before; if you don't like it, alter your pattern of action in appropriate degree and direction. It is perhaps naive to say that this does not involve forecasting, but the kind of forecasting it involves is not as to actual events, but as to the direction -- and in lesser degree the extent -- of the impact on events of the central bank's own actions. There is no need of a crystal ball, and none is available in any case. The bank should act on the basis of the latest report as to the trend of affairs. There will be a lag, a short one, between the actual events and the report thereon, but this lag will be of little consequence if the bank is always ready to alter its pattern of action in direction and in degree.

Considerable importance attaches to or is imputed to the "announcement" effects of central bank actions. I would retain whatever value there is in these effects by letting the drift of central bank action over a period of time instead of spectacular single action do the "announcing" or, still better, by providing explicit explanation of what the bank is doing and why.

This is in a sense a proposal for a revolution-

ary change in the normal procedure of central banking. In the United States it is scarcely a practicable change, given the size of the Federal Reserve Board and the extent to which its control over the central banking mechanism is shared with other agencies. In the United States the record as to why the Federal Reserve has reached certain decisions has to be prepared by staff members who can't be certain why the decisions were reached, even though they were sitting there; even the men who made the decisions may not know how they were reached.

That is one argument in favour of a single central banker.

COMMISSIONER MACKINTOSH: Can you make any operating decisions without taking a view of the future?

PROFESSOR VINER: If the operation is such that you can make it cumulative, freely, without any restriction or criticism of the regulations or law, and if you can make immediate reversals, I say yes. You work along certain lines with respect to the experience of the preceding week. If it has been the kind you want, you maintain it; if not, you reverse it. If it has been too weak in its effect, you strengthen it; if it has been too strong, you weaken it.

COMMISSIONER MACKINTOSH: Results are not that quick.

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every day of the week, because certain kinds of operations are restricted to Fridays or Mondays.

COMMISSIONER MACKINTOSH: You are basically assuming that next week is going to be like this week.

PROFESSOR VINER: I don't assume anything. I say I haven't the faintest idea of next week. I would go into it with an open and empty mind. If there had been a revelation to me, I would deny having received it. I would say, I don't know what will happen next week. All I would say is, I see pretty strong indications of what I ought to do now, based on the events of the week before last, and aiming at countervailing what I do not like about those events. But I don't pretend to know that events will be the same next week.

COMMISSIONER BROWN: And you are going to nudge the next week's changes back to the norm.

PROFESSOR VINER: Yes, but to the norm. for the week before last.

COMMISSIONER BROWN: And to that extent are you not looking ahead, trying to forecast the effect of your actions on a set of circumstances that happened last week?

PROFESSOR VINER: I think I indicated this morning that economics would be of no use if it provided us with no equipment for predicting. But I distinguished between predicting events and predicting the impact of an act. The true impact of an act, say a restrictive act, like open market sales by a central bank, needs to be predicted. The impact of such an

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If I were experienced, and had a lot of information and an excellent staff gathering the material all the time, and had a sensitive market, I would then offer a prediction as to the degree as well as the direction of impact. But I still would have no prediction as to what will in fact happen next week. It is in that sense that I say you don't have to predict events. It is not necessary to do so. It is not the function of the profession, or the government, including its civil service and its experts, or of the legislators to do so. The government need not feel it is terribly handicapped because it cannot see into the future. It may be good for the peace of its soul that it can't see into the future. It may be a happy situation that we don't know too much about tomorrow. But what we want to know is the probable impact on the events of tomorrow of what <u>we</u> do today.

COMMISSIONER BROWN: I may be misinterpreting what Professor Viner is saying. Are you saying that you have to make these moves because if you don't the

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COMMISSIONER BROWN: I may be misinterpreting what Professor Viner is saying. Are you saying that you have to make these moves because if you don't the

trend in existence will carry forward? In that sense it is a forecasting of events?

PROFESSOR VINER: If you push me into that position, yes, but I still say I don't pretend to know what will happen to the world if I do nothing. So I am not saying that I know or am predicting that what went on last week will continue to go on next week, unless I do something. On the contrary, I am denying information about tomorrow. I am directing my mind solely to the impact of what I, as central banker, actually do.

There is nobody in the United States who knows what the stock market trend is going to be on Wall Street next week; nobody has any means of forecasting it with any reliability, but I know 50 ways in which I could suggest the direction of the impact on the stock market of certain kinds of deeds. I could frame a statement for President Kennedy to make, and I would guarantee that it would have a bearish impact on the stock market the next day. I could also guarantee that I could frame a statement for him to make that would have a bullish impact on the stock market next week. What I am denying is that I can reliably predict that the stock market index in either case would in fact fall or rise, since other forces would also be at work. I can predict the direct impact of specific acts without thereby being made capable of predicting the net result of all the factors at work.

If you predict the weather tomorrow, you say that it will be raining or that there will be a high

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temperature. That is predicting an "event". But if you postulate what influence on the weather would be exerted by a north-west wind, I don't call that weather-forecasting because you are taking no account of the impact of other weather-influencing factors on temperature, humidity, and so forth.

COMMISSIONER GIBSON: Do I take it you would not be in favour of a bank rate or a discount rate being regarded as a signal?

PROFESSOR VINER: As a signal to the public?

COMMISSIONER GIBSON: Yes

PROFESSOR VINER: I see no virtue in central bankers acting as if they were dumb and had to resort to sign-language. I would much prefer that they use English.

COMMISSIONER BROWN: This brings up my next question. Would you distinguish in your opinion the relative effectiveness of actual changes in interest rate and changes in availability of money, and the induced psychological changes.

PROFESSOR VINER: I am most enthusiastic about that question, because it fits my mode of thought on these issues perfectly. I don't think I have ever expressed it myself in quite that way. I think that all three are vital: the announcement effect, the effect on the quantity of money, as technically defined and the effect on liquidity, in some broader sense than money-supply. And I believe I should add one more.

COMMISSIONER BROWN: Cost of money?

PROFESSOR VINER: Yes: the interest rate.

Interest rate changes ought to be regarded as a relatively unimportant factor, as mainly a by-product of central bank operations.

When the central banker is tightening money, he ought not to say, "We want interest rates higher." He ought to be more logical. He should say,"We want the quantity of money to be smaller, or, better, we want the flow of cash expenditures to be lessened, and the interest rate and the effect on it should be regarded as incidental."

In the earlier history of Canada -- and the authority on that is one of you -- as far as I can recall interest rate changes did not enter into any of the economic discussions before 1914, and there was no reason why they should. In my youth, before I went to college and later to pay my way through college, I was a bookkeeper in Montreal, and had charge of the bank financing of a small manufacturer. As I recall, the question as to interest rate never came up in anybody's mind. The interest rate was 6 per cent and it had been at that level as far back as the memory of man went. It had been 7 per cent elsewhere, perhaps 8 per cent on the prairies, but it did not change in Toronto or in Montreal over the years. It may have been slightly different for different categories of credit-worthiness. I had a wide open discussion with the banker once or maybe twice a year about the so-called line of credit:What would be the maximum indebtedness that my firm could have at the bank.

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used to leave availability out. In the Canadian experience before 1914 there was no central bank. There was no real discount rate. There were no changes in the rates that the banks themselves charged when dealing with Canadian customers.

If you believe that monetary control operates through changes in the interest rate then what kept Canada in balance for 75 years? It was on a convertible gold or U.S. dollar exchange basis. It was legally on the equivalent of a gold basis. So far as I know, up to 1914 from the beginning of time, so far as Canada was concerned, there had been no deviation, no weakness, no period of pressure of any sort that endangered the stability of the Canadian dollar, and there was no machinery visible whereby changes in interest rates operated as the means whereby equilibrium in Canada was maintained. That clearly shows that the interest rate is not an essential item in a system of monetary control.

How then was Canadian equilibrium maintained? If the Canadian exports were running down in price or volume there were Canadian individuals whose spending power was immediately and directly reduced to an important degree, and this impact passed on to other Canadians in the form of reduced spending power for them. This in some proportion operated to reduce imports and thus made a fairly direct contribution to restoration of equilibrium in the international balance. Similar deflationary influences on domestic investment and thus on imports of capital goods resulted from the decreased

exports. Such direct and spontaneous adjustment is largely over in the world today because practically every country in the world has substantially isolated its internal economy from the direct impact of its international transactions. If the international transactions are still somewhat equilibrating for the most part they have to work through the medium of a central bank machinery that may not permit the impacts to go through.

There is the famous statement of Sir Hugh Dalton in the House of Commons to the effect that the mystery to him was that England which was domestically so thoroughly liquid and which had no internal financial pressures on it at all should be under pressure in its international balance of payments. At that time he was himself creating pressure by the excess liquidity he was producing at home. It appeared to him to him a paradox.

In the 19th century that would have been a paradox. England and Canada in the 19th century, could not have been highly liquid at home and highly tight on the frontiers. The two would have coalesced. We now have machinery to separate them, and we have machinery to bring them together artificially.

In Canada, to make the point, I would say aside from the spontaneous factor -- I would not exaggerate its importance because it is fashionable to believe its importance has been grossly exaggerated in the past -- the banks were not merely acting as parts of a national mechanism when they decided on lines

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In Canada, to make the point, I would say aside from the spontaneous factor -- I would not exaggerate its importance because it is fashionable to believe its importance has been grossly exaggerated in the past -- the banks were not merely acting as parts of a national mechanism when they decided on lines

of credit. They were taking their own position into account. A small branch had its general line of direction, but at headquarters they could see the big picture in which the liquidity of the bank as a whole was taken into account. In the Canadian system, where the banks were relative giants, the national picture got directly into the commercial bank's own picture very substantially. Whereas in a country like the United States the "Kennebunk First National Bank" had no need to worry about the international balance of payments in extending its own credit, a Canadian Bank such as the Bank of Montreal, which in addition deliberately imposed upon itself a central banking kind of responsibility, was made conscious directly of the international situation, because it played such a large part in the economy. The two could not diverge too widely, and so the bank operated in an equilibrating fashion not by changing its interest rates but by tightening or loosening its lines of credit.

That is what I call availability of credit in an objective form, and it takes that objective form especially when for some reason institutional or legal variations in the rate of interest are not possible.

I do not recall any more, although I used to know these things whether there were legal restrictions, whether there was a maximum legal rate of interest, or ---

COMMISSIONER BROWN: There is a legal maximum on interest rates that the banks can charge now.

PROFESSOR VINER: What is it?

COMMISSIONER BROWN: 6 per cent.

PROFESSOR VINER: That is the maximum that they can charge?

COMMISSIONER BROWN: Yes.

PROFESSOR VINER: What does the customer who is not very credit-worthy do?

COMMISSIONER MACKINTOSH: He is rationed.

PROFESSOR VINER: Do they lend him only a certain amount, or do they not lend to him at all?

COMMISSIONER MACKINTOSH: He cannot get credit.

PROFESSOR VINER: It is rationing in that sense. I am thinking of a more healthier situation that is a more extreme form of rationing. A monetary control system cannot operate in an optimum way with a maximum of 6 per cent on the rate of interest in a country like Canada which may at times need a rate of 7 per cent or more as the normal rate. If the small man, no matter how reliable or able he is, cannot get the credit he needs at 6 per cent then he will have to go to finance houses to get it and he will have to pay perhaps 18 per cent. I believe it is an arbitrary maximum.

The English suffered under that sort of a maximum for two or three hundred years, and it caused them most serious embarrassment at times.

In any case, to return to your question, quite apart from credit rationing by the banks, there are many ways by which the process of reducing or increasing availability of credit can operate. Debt

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management seems to me important also because of its impact on liquidity as distinct from its impact on either the money supply and on availability of credit.

The significance in this respect of debt management is that the longer the average maturity of the national debt held by the public, given its total assets, then the less liquidity there is. Variations in the interest rate also affect the liquidity of holders of long-term debt. An increase in the interest rate reduces the value to the bondholder of his holdings, makes him feel poorer, reduces his command over credit, and because of his reluctance to take a loss restrains him from acquiring liquid assets by selling his bonds. In all these ways government financing by long-term instead of short-term issues has a substantially deflationary effect.

On the side of the ordinary householder, let us say, a rise in the rate of interest, however it comes about, creates an impairment of capital assets or of property assets by the normal processes of valuation. After a stock market crash a lot of people are poorer momentarily. If people's investing habits and spending habits are influenced appreciably by their own notions of what their income is, and the changes therein, and what their estates are, then changes in interest rates affect the propensities to spend.

A list of what operations and what kinds of things a central bank can do, or that a debt manager can do, that will tend to reduce the upward

pressure on prices, or the upward pressure on the rate of expenditures on consumer and capital goods including imported goods would be a long one, and it is a mistake to think of the control mechanism as consisting merely of changing the interest rate.

COMMISSIONER MACKINTOSH: May I ask two questions? With the much greater development of the money market and of the capital market is it possible to separate availability from the interest rate? In the historical illustration you gave us apparently it was, but with present day money markets and capital markets, if you restrict the availability will you not increase the interest rate?

PROFESSOR VINER: I am not so much concerned with minimizing the extent to which changes in interest rates are associated with the monetary mechanisms, whether as equilibrating factor or as a surface phenomenon, a by-product, but with warning against oversight of the importance even today of the rationing and availability factor. Today reduction of availability and increase in interest rate tend to be associated. In the United States, the rationing is in fact often more frank than the increase in interest rates. The fixing of the line of credit is more-or-less routine, but the increase in real interest rate may take the form of a requirement that a specified proportion of any loan must be kept as a non-interest-paying deposit.

COMMISSIONER MACKINTOSH: Does that achieve anything?

PROFESSOR VINER: What it means, in the first place, is that they are telling you how much they will lend you, and then they are telling you that their effective rate of interest will be, say, 7 per cent instead of the normal rate of 5 or 6 per cent. They use both availability and the interest rate to check the rate at which they lend. That is apparently part of the standard New York banking procedure.

I have a hunch that that may be the Canadian banking procedure as well, and also the Chicago banking procedure. I think that that hunch would be verified if it was investigated.

In other words, if you go to negotiate a line of credit you will find they will negotiate with you not only as to the normal interest rate and not merely the maximum sum they will lend you, but what proportion of that sum you will have to keep as an idle deposit.

COMMISSIONER BROWN: Why do they do it in that way?

PROFESSOR VINER: One reason is that they do not like to publish the fact that they are charging 6 or 7 per cent when the nominal rate is 5 per cent. Another reason is that this arrangement is flexible. They can change it during the term of the loan. If the money market gets easier they can relax the deposit requirement. I do not recall the term used for the required deposit.

COMMISSIONER BROWN: The compensating balance?

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COMMISSIONER BROWN: The compensating

PROFESSOR VINER: Yes, the compensating balance. The point is that the compensating balance can be more flexibly handled than the interest rate. You cannot re-bargain the interest rate during the life of the loan, but you can effectively do that in the size of the compensating balance. There may also be some legal limits on interest rates which can thus be evaded.

COMMISSIONER MACKINTOSH: That is the same thing that finance companies do. They have ways of having nominal interest rates and actual interest rates. I am not suggesting that banks may not find it better to operate at a fairly stable interest rate, but can you restrain the availability of credit without having an increase in the interest rate spread through your capital market and your money market, and through the system?

PROFESSOR VINER: I think the answer should definitely be no, but that it should be recognized that where rationing is operative it has an effect additional to the effect of the interest rate, and also that the effect of the rationing on the interest rate manifests itself in other sectors of the money market than the sector which is doing the rationing. There is an analogy in the multiple-exchange rate system, where exchange at the preferred rate is always rationed.

I have a hunch myself that rationing is not unhealthy. A banking system dealing with all kinds and grades of client can use two kinds of restraint or brake. One is rationing, or degree of availability and

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the other one is the rate. I am not criticizing this. I am only saying that interest rate variations are only one of the forms in which control of the volume of credit manifests itself.

COMMISSIONER MACKINTOSH: I would agree with that. I was just reacting against some current trends that it is either availability or interest rate. It is both.

PROFESSOR VINER: It can be both.

COMMISSIONER MACKINTOSH: It cannot avoid being both.

PROFESSOR VINER: It probably cannot. There are other reasons why that is true, even for an absolutely first-class credit-worthy corporation. It may be too big for its bank. In other words, the bank will say, "Yes, we are delighted to have you, but we cannot handle your $20 million transactions. You are too big for us and we have to put a ceiling on how much we will tie up with you alone." That is so in the United States, but in Canada your banks are giant banks. Where there is a unit banking system there often has to be a sharing of the financing of giant corporations between a number of banks. Otherwise there might be legal as well as prudential and asset restrictions as a bank might not be allowed to lend, say, more than 20 per cent of its capital to a single client.

COMMISSIONER MACKINTOSH: Would I infer correctly that you would not attach much importance to the sort of linkage among rates that you have in England, where all the deposit and loans rates

are pretty well linked to the bank rate?

PROFESSOR VINER: I am not well informed on that, but it has a certain convenience, that if the central bank really knows why it is doing it,and the reason happens to be a good reason ---

COMMISSIONER MACKINTOSH: This does seem to emphasize the rate?

PROFESSOR VINER: Yes, it does but not necessarily in a logical way. One of the things that can happen in England is that when the Bank of England for its own reasons, wants the rate to be increased, and the banks follow it, the banks may follow it and then go out drumming for increased business.

Under the English system an English bank follows the Bank of England rate with the mark-up automatically and mechanically without reference to the state of the economy or of its own liquidity. And when the Bank rate goes up that is an increasing incentive for the English Commercial Banks to go out and drum up business, though the motive of the increase in rate on the part of the Bank of England, is, presumably, to act as a brake.

I think that in the English system it is quite possible, with an increase in rate, for an English commercial bank to lend with greater zeal because it is more profitable to do so.

COMMISSIONER MACKINTOSH: We can assume the Bank of England would affect the availability of cash to the banks at the same time.

PROFESSOR VINER: Yes, but only if it

takes additional steps.

COMMISSIONER MACKINTOSH: No, at the same time?

PROFESSOR VINER: I think the signal rise in rate, when it is supposed to be an inducement to banks to follow suit, must not have an element of profitability to the bank following suit -- from increasing both the rate and the quantity,because the quantity is the more important. The English system may work all right, but it could work in a very perverse way.

My feeling about "signals" is that a long time ago language was invented, and wherever possible and wherever it will work, one should use it. At the present time a Bank of England signal is a signal to the large banks in England that, "You can charge your customers more for whatever services you render them." But it is not a signal that they should reduce the volume of services they render. I make no claim based on knowledge of English experience that it does not work all right.

THE CHAIRMAN: Professor Viner, there are just one or two questions I would like to ask you about some of the other instruments of monetary policy.

I think you have covered the bank rate as fully as perhaps you had in mind to; and also with regard to interest rate ceilings there has been a sufficient discussion.

The next one I wish to mention is the cash ratio. Could you express your views as to the

use of the cash ratios as an instrument of monetary policy; and, along with that, the liquidity rate? You understand me?

PROFESSOR VINER: Yes, I think I do, and if not it will come out.

Well, my own understanding of the problem is that no matter how you define cash the cash ratio is not the whole story of liquidity. The English, in fact, do not find very interesting the report of their cash ratio, which is very small, and it is not the thing on which they form their decisions. They form their decisions on the basis of what they call the liquidity ratio. Logically, it seems to me that is perfectly sensible.

Actually, as an operating thing, how do you equate near liquidity with absolute liquidity or absolute cash? I would say it is a matter of judgment. In my type of central banking it would not be a serious problem because you are feeling your way all the time and if you are not getting the results desired you probably reverse or repeat or intensify your action according to which is appropriate. But given a different type of central banking how do you equate secondary reserves to primary in the form of actual cash?

I would say that a banking system's liquidity should be computed in terms of a weighted average of its assets classified by their time difference from cash to its liabilities. But you can never administer a banking control system

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on the basis of a simple formula using weighted averages of maturities of that sort. I do think that stress on what I will call secondary reserves is perfectly wise and sound, except they should not be pooled on an equal basis with the actual cash reserves, and I would like to see two ratios used, the absolute cash liquidity and the liquidity with respect to other types of assets. I am sorry, I have lost the trend of your question.

THE CHAIRMAN: I just wanted an elaboration, up to a point, of the cash ratio as an instrument of monetary policy.

PROFESSOR VINER: Yes, I remember, thank you.

THE CHAIRMAN: As you know, in our system we have the percentage of deposits the central bank can operate on to bring about expansion or contraction of credit. It is similar to yours.

PROFESSOR VINER: Yes. My own feeling is that a ratio based on pooled assets of cash and near cash is too simple for use. So I would have two separate ratios. I would not make it too complicated, but in pure theory I would have the assets graded as to their reserve significance, to figure whether the bank is as liquid as you think it ought to be in the light of the situation.

On the question of reserve requirements as an instrument of control, I think some of the new experiments that have been made in lesser countries, in the post-World War II period, deserve examination.

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On the question of reserve requirements as an instrument of control, I think some of the new experiments that have been made in lesser countries, in the post-World War II period, deserve examination.

Growth ratios of loans or liabilities may be significant and ratios which discriminate between an expansion you regard as dangerous and one you regard as healthy or even essential -- it may be possible to do so by having more complicated formulae for reserve requirements without involving direct selective control over the banking system's credit-granting activities. But, in general I think that in the United States the distinction between demand and time deposits in computing required reserve ratios needs refinement because the line between the deposit liabilities of the banks subject to one reserve ratio and those subject to another and higher reserve ratio is so easy to cross; the deposits,without changing their character, can change their denomination. Customers can shift their accounts from one class to the other without significantly changing their own liquidity or that of their bank.

Moreover, the demand deposit of the kind I have just indicated,which is a required fraction of your loan upon which you cannot draw is just a disguised way of charging you more interest. It need not require any reserve ratio at all; it is not useable at all by the customer. It is not merely like a time deposit which you can make more liquid by converting it to a cash deposit. When a bank lends $100,000. of which $20,000. is frozen, it is really lending only $80,000. Under the American system that $20,000. requires as much reserve as the most volatile part of the $100,000. "deposit".

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Growth ratios of loans or liabilities may be significant and ratios which discriminate between an expansion you regard as dangerous and one you regard as healthy or even essential -- it may be possible to do so by having more complicated formulae for reserve requirements with- [illegible] system's credit-granting activities. But, in general I think that in the United States the distinction betwee demand and time deposits in computing required reserve ratios needs refinement because the line between the deposit liabilities of the banks subject to one reserve ratio and those subject to another and higher reserve ratio is so easy to cross; the deposits,without changing their character, can change their denomination. Customers can shift their accounts from one class to the other without significantly changing their own [illegible]

Moreover, the demand deposit of the kind I have just indicated,which is a required fraction of your loan upon which you cannot draw is just a disguised way of charging you more interest. It need not require any reserve ratio at all: it is not useable at all by the customer. It is not merely like a time deposit which you can make more liquid by converting it to a cash deposit. When a bank lends $100,000. of which $20,000. is frozen, it is really lending only $80,000. Under the American system that $20,000. requires as much reserve as the most volatile part of the $100,000. "deposit".

There is no reason to take as sacred the

inherited, traditional devices and formulae used in operating central credit control; and, in fact, some of the smaller countries have perhaps devised some tools which are more logical than those used by the more mature and experienced countries. One of these is to base reserve ratio requirements on the rate of expansion of liabilities rather than on the absolute volume. Another is the taking of reserves away from banks or putting restraints on their use.

COMMISSIONER GIBSON: What do you mean by "ratios based on expansion of liabilities"?

PROFESSOR VINER: I believe that in some of the Latin American countries you have to keep on reserve with the central bank, a larger percentage of an increase of your deposit liability over a stated period of time than the basic reserve ratio.

COMMISSIONER GIBSON: Like the British system of putting extra liquidity in certain accounts of the Bank of England under certain circumstances?

PROFESSOR VINER: That may be. There are many possible ways of proportioning required reserve ratios to the rate and direction of movement of the volume of a bank's liabilities.

There are difficulties, and I am not advocating it, but I know that reserve requirements can be structured to attain the purpose of banking control in a more refined manner than by simply having an average reserve ratio requirement against bank liabilities without account of the kind of liabilities, their pattern of change, and so on.

Let me add a type of change in reserve requirements which I once suggested as a "second-best" or "lesser evil" device. At a time when the American government was putting pressure on the banks to invest in the government debt, I said that one possible arrangement would be to allow the banks to have reserves against their assets and not against their liabilities, and then you could discriminate as to the character of the assets. Then you could require zero reserves against holdings of government bonds, and 80 per cent if you like, on commercial loans. My suggestion was not serious, and I did not want that procedure at all except as an alternative to the banks being subjected by force to buying government bonds. My own feeling is however that differentiation on the assets side is more logical for credit control purposes than differentiation on the liabilities side of a bank's balance sheet.

There is not any one correct way of putting reserve requirements on banks. There is a range of ways in use today, and I may say the range has been in large part discovered and invented by new central banks looking with a fresh mind on the possibilities. But once more I would say that decision as to what is the optimum system of reserve requirements needs first a careful statement of the purposes. You may be doing it for the safety of depositors, and for that one sort of system may be good, but you may be doing it as a monetary control to keep the system stable, so that the system of reserve requirements

of banks needs, I would say, periodic re-consideration What purpose do you want it to serve and for this purpose is the present arrangement the best you can think of? But without linking up the purposes and the arrangements, it will be just good luck if what you get is really serving any useful purpose.

THE CHAIRMAN: We will adjourn now for 10 minutes.

--- Recess.

COMMISSIONER LEMAN: I would like to ask you a question, but it is a question which is not too broad in this field. When in Canada we feel there is justification for tighter money, there has crept into our setup a situation which relates to what we call near banks and their reaction to this action by the monetary authorities. We are not quite sure sometimes if we are really talking only about fairness or not, because the banks must react to the monetary action and these other institutions have ways of not reacting quite so readily.

Do you have any views on that as to whether in general it is better, when you know that an action must have a result, to make sure that it has the same result with everyone?

PROFESSOR VINER: I think there are two kinds of issues there; one is the effectiveness of the control for the purposes of the control, and the second is not merely a question of fairness as between different kinds of financial institutions,

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but what kind of a financial setup do you want to encourage, and so on. You quite conceivably may have a very discriminatory system of controls which is perfectly effective in terms of the larger policies, but at the same time you may be distorting your credit institutions by what happens to be a traditional survival of obsolete control patterns, which, in addition to being inefficient in serving its purposes is also unfair and arbitrary.

There are both banks and near banks in every country, advanced or semi-advanced. Whether controls should be confined to banks is important only if it is important where the initial impact of control occurs.

Now, I personally believe that the point of impact is not very important in terms of the major purposes of credit control, although persons whose judgment I respect and whose information is superior to mine do say it is important. But I do think that as far as possible monetary and fiscal controls ought to be neutral with respect to the competition between different types of credit institutions. In other words, differential impacts of the control procedures that have no national purpose, although they may have important secondary and national significance, should be avoided as far as is practicable.

In the United States there are so-called savings banks in certain states under state regulation, and there are commercial banks which are federally controlled.

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In the United States there are so-called savings banks in certain states under state regulation, and there are commercial banks which are federally controlled.

Now, is that a logical dividing point? In the United States we have commercial banks that are not members of the Federal Reserve System at all, we have State banks, and we have national banks, we have a variety of banks and the impact of the general controls is somewhat different on all of them and is negligible on some, except as these impacts spread in a secondary stage by the inter-flow of their effects through the general banking tissue of the banking system as a whole.

In the United States it is often a political issue as to what institutions shall be subject to the general credit controls, and the political forces in general are against central bank control because there are local loyalties. In this country you get generalized bank control almost automatically because your banking institutions operate across the Dominion, so that you start out with a position of advantage. From my neutral point of view and in the absence of special reason for it, I don't want to discriminate between the different forms of financial institutions, and I am under the impression that you also have borderline institutions that are not regulated commercial banks subject to controls, but nevertheless carry on operations very much parallel to the operations of your commercial banks. Your problem in that respect -- although I believe in a much lesser degree -- is like ours. Maybe you even have provincial institutions, not subject to federal control. I am not sure, but in the past there were

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some. I believe there were once one or two banking institutions in the Province of Quebec which were not in any way subject to central control.

COMMISSIONER LEMAN: Could this be an issue? This morning I think you told us that without using very sharp instruments sometimes when you notice that there are rigidities like administered prices, perhaps because the labour unions haven't fallen in with the philosophy that persuasion will go a long way to solving a lot of these problems. I believe you told us that this morning, and perhaps this is an area where you feel that persuasion could also work.

PROFESSOR VINER: Let me make clear the point which is very important to me. Secret persuasion, persuasion off the record, I abhor, so when I do seem to be speaking for moral suasion, it is by open and general statement in terms of a set of general and known principles, and not by ad hoc and ad hominem nudging and pursuing.

For instance, in the field of collective bargaining I think it is a very serious defect in a democracy when an agency intervenes -- except in the height of an emergency -- and applies moral suasion to one of the parties without benefit of an established set of rules and of general principles to which they can refer. I wouldn't like to see such procedures applied to the banking system as well.

Where the individuals are genuine individuals and therefore individually weak and

unimportant, I would let every individual do as he pleases subject to general rules applied equally by the government. Now that there are unions and firms and banks which are not "individuals" but giants, they need more detailed regulation. My point is to let it be on the record that even with respect to these giants, intervention shall be only with reference to publicly stated reasons and in accordance with publicly formulated patterns of behaviour.

COMMISSIONER LEMAN: Open persuasion?

PROFESSOR VINER: Yes, open, but not necessarily effective. Disclose the circumstances, disclose the logic - do it the way a college professor might do it in a general exposition to a mature class. Let them make their responses as to what the call of duty is in the light of their own special circumstances. At least, do it on an experimental basis and see how it works. My point is that not only statutes and regulations but also administrative efforts at persuasion should be subject to rules of due process. I would dislike a central bank system which involves a bank official phoning a huge corporation and requesting it to do or not to do so and so. I don't think that is healthy and yet it is the way collective bargaining is administered now in the United States when the government intervenes. It involves personal intervention without stated principles, or with principles which are stated and justified very meagerly so that as an economist and as a neutral I am sometimes inclined to advise: "Don't do it because of the manner

in which you have been asked to do it". I don't like a society in which you have officers who can express wishes to you and then put you under heavy pressure to conform to them.

COMMISSIONER MACKINTOSH: I wonder if you would clear my mind on some things which you said this morning. I wasn't quite sure whether you ended up your discussion rather favouring a fixed rate of exchange rather than a floating rate?

PROFESSOR VINER: Well, I tried not to be a bigot. In general, I like the presumption to be in favour of working on free market forces and would interfere only after careful consideration, as far as possible by general rule, and only with weighty reasons.

Now, a flexible exchange is an example of a flexible "price", like, say, a flexible cotton price, if I may suppose that the cotton price is a quite free and unmanipulated price. But to apply to the foreign exchange market the logic of a perfectly free and perfectly flexible economy we have to overlook the fact that we are in a world of sluggish prices, of administered prices, of rigged prices, of collective bargaining prices, of government-regulated prices. Of all prices, why should you single out the exchange value of your currency as almost the only price of major importance which is left subject only to the forces of the free market?

In a world of free-market prices, I might be for a foreign-exchange market with which government in no way interferes, directly or indirectly.

In a world such as ours where markets are only very partially free, I still concede that I have no logically satisfactory formula for regulating foreign exchange rates, and whatever regulation, direct or indirect, I support is supported by me without enthusiasm and only as presumptively less objectionable than any alternative that seems available. There are valid and important objections to fixing the gold value of a national currency as a means of influencing its foreign exchange value, of which perhaps the weightiest is that it is arbitrary, that it is not under modern conditions a reliable guarantee of stable foreign exchange rates, that it is liable to be a cause of deflation, and that it is only a partial and somewhat unreliable protection against inflation. If there were a country which could be counted on to be able and willing to maintain a stable price level through boom and recession, I would urge it to free itself from any link to gold until price-stabilization was a major goal successfully pursued by the bulk of the free world. Given conditions as they are, however, I favor a strong but not completely unbreakable link between national currencies and gold, with the currency value of gold alterable only by international action or where it is fostering either extreme deflation or extreme inflation.

If fixed currency-values for gold threatened to result in serious inflation or deflation for the free world at large, I would support appropriate alterations in the monetary price of gold by international agreement but I don't feel that this is for

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the time being an urgent problem.

There is substantial flexibility, given a moderate amount of organized international co-operation, in the minimum gold reserve adequate for the currency systems of the free world without involving general deflationary pressure.

I do not claim that it is in theory or in practice impossible for a floating exchange system to operate satisfactorily for a particular country. But for confidence that this will be the case for any particular country to be warranted certain quite exacting conditions need to be met. One is that there shall be justified confidence in the workings of market forces in markets with their prevalent imperfections as compared to the free-market model of economic theory. Another is that the public of that country shall have complete and justified trust that its government will not use the freedom which a floating exchange gives it to resort to inflationary tax and expenditure activities. Another is that the government will not use the freedom from gold or fixed-exchange restrictions to manipulate the exchanges by indirect means in what may be from the point of view of the national interest wisely conceived a perverse pattern. An exchange to be genuinely floating must be free from any pattern, open or concealed, of government interference with it, but an exchange set up as floating in appearance is thereby available to manipulation by government in any degree or direction provided only that the means used are indirect and their purpose to influence the exchange rate is not acknowledged

officially.

I know of only two instances of full-fledged floating exchanges, the Canadian and the Peruvian, both now dead, but both deaths bemoaned by many economists. I am not well enough informed to appraise the workings of either of these experiments.

I concede that some of the fears I had about the working of a floating exchange for any country did not eventuate at least for a number of years in Canada. I derive from that one or the other of two conclusions: That the Canadian people had a great degree of confidence in the wisdom, integrity and foresight of their government and its agencies including the Bank of Canada itself; or, secondly, the community was without ideas on the subject sufficient to bring it to a state of distrust and apprehension.

In the United States there prevails special admiration for the wisdom and ability of Canada's higher civil servants, and for the wisdom and integrity of Canadian politicians in that they respect the quality of their civil service and deal with it as a good democratic government should deal with a brilliant and dedicated civil service. This contributes to the belief that whatever might be the case in other countries, Canada could survive and even flourish under a floating exchange.

I do not understand the events of the past eighteen months. They are hazy to me. One of the things I am not sure of -- and I get conflicting reports from American experts -- is as to how one finds

whether an exchange is genuinely a floating exchange.

A perfect floating exchange is probably an inconceivable thing, if one defines it strictly. How close Canada came to it in this period, I don't know.

If you ask me what objections to floating exchanges I would raise in principle without disregarding the little I know of Canada's experience, I would say that the Canadian experience has taught me that a floating exchange is not necessarily as disastrous as I might have expected it to be. But I still feel that a wide range of countries -- and in this range I include the United States with qualifications -- are not to be trusted with a floating exchange; and that the fixed exchange rate cult, myth, rigidity, illogicality though it be, is the sole surviving barrier to unrestrained inflation in many countries.

I feel at the present time the fact that in the United States we have a fixed gold value on currency or a fixed rate of exchange, the fact that we have one or the other, or both of those, is one of the important factors of an inadequate stock of factors which supports belief that on the whole the United States government over the next few years will follow a fairly sober financial policy.

Tying a currency to gold, or to fixed exchange rates, is not a logical principle. There are circumstances in which it could be a stimulus to inflation. Under other and more probable circumstances,

whether an exchange is genuinely a floating exchange.

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it could bring about disastrous deflation.

So, in principle I have nothing to say for the gold standard; in principle, I have nothing to say for fixed exchange rates; in principle, I am biased in favour of thoroughly complete economic freedom subject only to general policies and general rules. But in the light of the actual picture, what country can be safely relied upon always to act with sobriety when freed by a floating exchange rate from the budgetary restraints imposed by the necessity of maintaining exchange parity or gold parity? The number of countries which belong to that list has never been very large, and I would not at the present time include the United States in such a list.

COMMISSIONER MACKINTOSH: I take it you look on the exchange rate as a mosaic law on divorce: It is a concession to the wickedness of the people.

PROFESSOR VINER: Yes. In a way it is like putting a chain and anchor on the legs of your citizens at random, because you are not sure which ones are dishonest and which are honest and can be safely allowed to roam the streets at night.

I have no recommendation to make as to what specific exchange rate policy Canada should follow in the near future. The range of information I would want before I would venture to tender advice as to what Canada ought to do with respect to the exchange value of its currency, or the pattern whereby the exchanges are determined, requires much more knowledge than I have at the present time. What are

the points on which I am conscious of being ignorant? I have not seen any detailed study of Canada's balance of payments. I don't know just how intense the balance of payments pressure is and how much of it is due to bear speculation. I know there has occurred a very serious drain on Canada's international liquid assets, but I don't know whether the character of it was such as to portend serious pressures continuing into the distant future, or whether there was a lot of very itchy money that had come in here and has now been taken back, and that that is the end of the story.

In any case, there are very high opinions in the United States as to the future prospects of Canada, as to the wisdom, solidarity and genius of your government, as to the absence of defects in your political procedures and so forth. There have even been some in the United States who invested money in Canada thinking this is a haven for all the kinds of economic virtues which seemed to them to be in short supply in the United States. Canada no doubt is a special haven for some economic virtues. I would nevertheless not have forecast it as being capable of living in reasonable safety with a floating exchange. But I seem to have been mistaken -- it is also the country of Social Credit and other queer manifestations of economic doctrine. It is a country in which economic ignorance in the population is spread apparently in about the same general proportions as in other distinguished countries which intermittently get into serious difficulties by

departing from traditional restraints on financial and monetary experimentation.

You see, the balance of payments is a very elastic and flexible term. There is also an international balance of obligations to abroad and claims on abroad not immediately current which needs to be brought into the picture. What is the balance of Canada with reference to the outside world? What are the potential claims that foreigners can make on you, and that you can make on foreigners? What are the prospects of your export markets? What are the prospects of your import requirements and demands? What are the prospects as to the fiscal policy and the fiscal measures you are going to take? All these things have to be evaluated before the Canadian dollar can be appraised, or intelligently prescribed for. I just do not know enough to undertake this task.

COMMISSIONER MACKINTOSH: I think those are all the questions I have, Mr. Chairman. We have kept Professor Viner here a very long time.

THE CHAIRMAN: That concludes today's hearing. May I express to you, Professor Viner, the appreciation of the Commission of your presence here today, and of the tremendous amount of information you have given us. This discussion has been fascinating and provocative, and it will be of great assistance to us in our endeavours.

PROFESSOR VINER: May I thank you for your patience with me, Mr. Chairman, and may I apologize for the abstract and vague character of my

answers to the searching and relevant questions you and your colleagues have put to me.

THE CHAIRMAN: We shall resume tomorrow morning at 9.15 to hear Sir Denis Robertson. We will now adjourn.

--- Adjournment.

....Page 5107 follows....

ROYAL COMMISSION ON BANKING

AND FINANCE

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Hearings held at Ottawa,
Ontario, on Thursday,
September 20th, 1962.

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THE COMMISSION

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Chief Justice of Ontario
Toronto, Ontario - Chairman

Mr. W. Thomas Brown, M.B.E.
Investment Dealer
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.
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Montreal, Quebec

* Mr. John C. MacKeen
Corporation Executive
Halifax, Nova Scotia

Dr. W. A. Mackintosh
Vice-Chancellor
Queen's University
Kingston, Ontario

- - - - - -

Mr. H. A. Hampson - Secretary

*Mr. Gilles Mercure - Joint Secretary

* Absent

Ottawa, Ontario,
Thursday,
September 20, 1962.

--- On resuming at 9.15 A.M.

THE CHAIRMAN: Call the meeting to order.

We have this morning a submission from Sir Dennis Robertson, who is one of Great Britain's foremost monetary economists. He is a retired professor of economics at Cambridge University.

Sir Dennis, I understand that you would prefer to have questions put to you at the outset rather than make any further statement yourself?

SIR DENNIS ROBERTSON: I think so, sir.

THE CHAIRMAN: We have all read your brief with very great interest and we are familiar with the points raised in it, and I think most of the Commissioners will have questions on points they wish to pursue a bit further.

COMMISSIONER MACKINTOSH: Sir Dennis, if I could ask for some simple elucidation, and to set out the concept of monetary equilibrium in rough terms, I take it to be that the money flow should equal the real flow in order to have a stable level of prices -- stating it very crudely -- and as you yourself said, some simple type of objective of stability of the general price level. How would you interpret that in terms of measurements of this? We had Dr. Bernstein here the other day who was in favour of prices of industrial products rather than a consumer price level. I understood from him that that was on the ground that there was an undue weighting of the wages

September 20,

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through services regarding consumer price levels. How do you interpret stability of the general price level?

SIR DENNIS ROBERTSON: Well, as I have said, I think stability of the price level in any ordinary sense is really a compromise; that there is a lot to be said on theoretical grounds for attempting to stabilize not any level of commodity prices, but a level of prices of productive services.

What that would amount to in a community which is making progress is a gradual fall over time in the prices of commodities, and I believe myself that that is an easier objective to defend on theoretical grounds than stability of any commodity price level.

As I have said in my paper, I regard that now as rather a thing that people do not find easy to understand, and therefore I would accept as a compromise, as a practical objective, the stabilization in some sense of the prices of commodities, but that means that with all these possible varieties none of them is more right than any other. What people are most interested in seems to be the level of consumer prices, but to be a little more scientific you can say that you are interested in the level of final prices, counting producer goods as well as consumer goods, but I think that there is not much reason for prefering any one of these theoretically to any other; they are all approximations of what one is attempting to do.

COMMISSIONER MACKINTOSH: What sort of signals would you expect the central banker to take account of in

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COMMISSIONER MACINTOSH: What sort of signals would you expect the central banker to take account of in

following this?

SIR DENNIS ROBERTSON: I think central bankers probably have to take account of all sorts of signals other than prices. I wouldn't like to think that the central bank was definitely trying to stabilize any particular index number whatever. I think the central bank, like the general economic statesman, has got to be looking out for other things, levels of employment and activity and many other things, but among these things I should have thought that the price level of consumer goods was that which was most deserving of attention, as it were.

As I have said in my paper, I would be very careful not to think that the monetary system had failed because in the event, for instance, of a succession of bad harvests the price level was going up. I think it is in a sense right that if nature is being malignant you have a natural effect in everybody finding their costs of living increasing, so if one is considering the relations of one country with the rest of the world, if the terms of trade are, for good and intelligible reasons, turning against that country because the things it supplies have become less needed in the world or the things it is buying have become scarcer, then I think one would have to be prepared to see the consumer price level going up a bit gradually. So I do not think any of these things are sacrosanct, as it were; they are indications as to whether we are on the right line, but no more.

COMMISSIONER MACKINTOSH: You favour, I would

take it from what you say, a monetary policy being essentially discretionary rather than following measures and mechanical rules?

SIR DENNIS ROBERTSON: Yes. I don't think one can get away from that now. I think you have to trust somebody, somebody's discretion in the end; you can't hope to get a mechanical system which would give you the right result.

COMMISSIONER MACKINTOSH: What is your view with respect to Friedman in this proposition?

SIR DENNIS ROBERTSON: Well, I am going to remind the Commission that I am now retired and I therefore don't feel bound to read everything that everybody writes, and I am not going to pretend to have read things I did not read. I must not claim to have studied his work properly, I can't comment on it expertly, but my hunch is that you can't get away in the last result ---

COMMISSIONER MACKINTOSH: I wasn't really asking for a critique of Friedman, but simply an idea that you could speak on it.

SIR DENNIS ROBERTSON: I would be very loathe to believe that myself.

COMMISSIONER MACKINTOSH: You have in the earlier section of your brief a good deal to say about the phenomenon of growth and its source. Is this something that monetary policy takes account of, is it something which it can make a positive contribution to, assuming that the country wants a policy of growth.

SIR DENNIS ROBERTSON: I think monetary policy

must take account of it, and, in a sense, always has in the countries which have grown in the past. The monetary system was developing, pari passu, roughly with the general economic structure.

I may have seemed a little impertinent about growth, but in my generation we were a little bit amused by this sudden interest in growth as if it were a new idea that nobody had ever had before, but all the books on economy and the principles of economy, as I was brought up, were all studies of a growing economy, and it was assumed that it would be growing and everything would be adjusted to that. Then, of course, we had a prolonged period of stagnation in the 1930's when people forgot about the fact that you could grow and now it has been rather a discovery by the young people -- by Jove, we ought to be growing, and they make rather more fuss about it than the concept, it seems to me, warrants, but it doesn't mean that I think we ought not to be growing; I think we ought, and monetary policy has got to be adapted to that.

COMMISSIONER MACKINTOSH: Is this, you might say, a sort of permissive thing, that you accommodate monetary policy to the growth, or can you get some positive push?

SIR DENNIS ROBERTSON: I think the dangers of trying to make monetary policy -- of straining it, so to speak, so as to promote growth. You quite often wish to go right ahead -- and by certain monetary action you can make yourself grow just a little bit quicker than if you did not take the action, but

[illegible] it. And, in a sense, already has in the countries which have been in the past. The monetary system was developing, pari passu, roughly with the general economic situation.

I may have cast a little [illegible] scorn on growth, but in my generation we were a little bit amused by this sudden interest in growth as if it were a new idea that nobody had ever had before, but all the books on economy and the principles of economy, as I was brought up, were all founded on a growing economy, and it was assumed that it would be growing and everything would be adjusted to that. Then, of course, we had a prolonged period of stagnation in the 1930s when people forgot about the fact that you could grow, and now it has been rather a discovery of the young people -- by Jove, we ought to be growing, and they make rather more fuss about it than the elderly. It seems to me, warrants, but it doesn't mean that I think we ought not to be growing. I think we ought, and monetary policy has got to be adapted to that.

COMMISSIONER MACINTOSH: Is this, you might say, a sort of permissive thing, that you accommodate monetary policy to the growth, or can you get some positive push?

SIR [illegible]: I think the danger of trying to make monetary policy -- of straining it, so to speak, so as to promote growth. You quite often wish to go right ahead -- and by certain monetary action you can make yourself grow just a little

the danger is that that will be a spurt, and if what you want is steady growth and not the quickest possible immediate rate of growth, then you would be in trouble.

There is a danger, I think, of monetary systems being perverted to securing an unhealthily rapid, immediate rate of growth. I don't know if that answers your question.

COMMISSIONER MACKINTOSH: Yes, I think it does in part. May an economy attain its objective of monetary equilibrium or stable prices and still be left with a substantial problem of unemployment? What difference in policy does this mean?

SIR DENNIS ROBERTSON: Well, that is the crux, I absolutely agree. I suppose that there are some kinds of unemployment which no monetary policy could do very much to relieve, but there are other kinds which you may be able to lessen by monetary action, but at a cost; at a cost of preserving inefficiencies of structure in our system. But there are other kinds of unemployment again which a good monetary policy can be really effective in curing or, at any rate, diminishing and it is an extraordinarily difficult question of policy, I think, to distinguish what I have called the three sorts of unemployment -- those that monetary policy cannot touch, those which it may be able to touch but at an excessive cost in inefficiency, and those -- the cyclical unemployment -- which it really can make a positive contribution to curing, and I am afraid that that is the art of the statesman, to aim

at curing what can be cured and not try to cure what cannot be cured by monetary methods.

COMMISSIONER MACKINTOSH: You wouldn't put the first class beyond the reach of economic policy as distinguished from monetary policy, would you?

SIR DENNIS ROBERTSON: No. There are some sorts of not being at work, of unemployment in the broad sense of not being at work, which I suppose nobody would want to cure in the sense that one wouldn't want a system to be so rigid that there is no remedy of flexibility in labour at all. What you want is to prevent such unemployment as does emerge in a free system from leading to social distress by your systems of insurance, and so on. But there are other kinds of unemployment which we should hope to lessen by good policies and by the mobility of labour, and so on, which we can't do very much about by monetary means.

COMMISSIONER MACKINTOSH: And wherever there is a lack or an inadequate demand, would you say monetary policy there can be helpful?

SIR DENNIS ROBERTSON: It can be helpful, but there I think you ought to be conscious of the question of price. You can have an inadequate demand, but a demand for anything, whether labour or anything else, is a demand at a price, isn't it?

COMMISSIONER MACKINTOSH: Yes.

SIR DENNIS ROBERTSON: And if a seller of something, whether it is labour or anything else, puts an exorbitant price upon it, then any level of demand

may appear to be inadequate. I suppose a given level of monetary demand means a general willingness on the part of the final buyers to spend so many dollars per year, but one has to ask why is that inadequate. Isn't there some level of price at which it would be perfectly adequate?

COMMISSIONER MACKINTOSH: That brings us to the practical question of whether it is not really hopeless to wait for such an adjustment of wages as would set a country in motion again. Can you really set it out? Will wages, the general level of wages, adjust itself?

SIR DENNIS ROBERTSON: It depends whether you are thinking of an absolute fall from a stable level or whether you are assuming, as I think we ought to be assuming, a condition of growth.

COMMISSIONER MACKINTOSH: Yes.

SIR DENNIS ROBERTSON: One can conceive of a society in which it could be hopeless to bring about an absolute fall in the level of money wages but in which it is not impossible to hope that the pace of rise of the money wage level shall be under some kind of control. That may be very important. If you think in terms not of a general level but of a rate of rise, it seems to me there may be some rates of rise of money wages which would make any attempt to control demand hopeless.

COMMISSIONER MACKINTOSH: You have a sentence on page 3 of your submission, Sir Dennis, at the top of the page, in which you refer with some applicability to Canada to the possibility that a short period of needed digestion and re-appraisal, after a specially rapid upthrust, may face her with a temporary problem of superfluity of manpower from which a less dynamic economy would be exempt, and with which purely financial policies may prove inadequate to cope.

Would you care to elaborate a little the limitations that you imply there?

SIR DENNIS ROBERTSON: I think I am revealing my great ignorance of conditions here but I am suggesting it is possible at any rate that your

labour is not in all respects well adjusted to the particular things that are now required. If I am right, perhaps not Canada but some country may be undergoing a period of very rapid development with great building of trans-continental railways or seaways or whatever it may be in which a lot of tough physical labour is required, and that country may be attracting labour of that kind from all over the world. Then almost inevitably one sees that when great works are completed there is a pause and nobody can quite see what is the next thing to be done. Therefore, you may find that this particular kind of labour, relatively unskilled, male labour, is a bit of a drug on the market, whereas at the same time new industries requiring delicacy of touch, and so on, are developing in service industries in the cities and there is considerable demand particularly for female labour, and your labour supply turns out to be ill-adjusted to the particular requirements of the moment.

You ask me what to do about it. Well, I do not know. I do not pretend to have any cure for these things. I say that one can hardly hope one will not get periods of that sort in the history of a rapidly-developing country.

COMMISSIONER MACKINTOSH: Your statement that purely financial policies may prove inadequate to cope with this does not mean that they cannot be said to help?

SIR DENNIS ROBERTSON: No, I do not think

labour is not in all respects well adjusted to the particular things that are now required. If I am right, perhaps not Canada but some country may be undergoing a period of very rapid development with great building of trans-continental railways or seaways or whatever it may be in which a lot of tough physical labour is required, and that country may be attracting labour of that kind from all over the world. Then almost inevitably one sees that when great works are completed there is a pause and nobody can quite see what is the next thing to be done. Therefore, you may find that this particular kind of labour, relatively unskilled, rate labour, is a bit of a drug on the market, whereas at the same time new industries requiring delicacy of touch, and so on, are developing in certain industries in the cities and there is another side demand particularly for female labour, and you cannot surely tame out to all adjusted to the particular requirements of the moment.

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SIR DENNIS [illegible]

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COMMISSIONER MACKINTOSH: This is more a personal than an official question, but would your phrase, "a short period of needed digestion and re-appraisal" have any relation to what you quite a few years ago referred to as a primary depression as contrasted with a secondary depression?

SIR DENNIS ROBERTSON: I do not think those were my phrases, were they?

COMMISSIONER MACKINTOSH: I may have the wrong term. My recollection was, "a period which had an economic function to perform".

SIR DENNIS ROBERTSON: Yes, I think it may have an economic function to perform.

COMMISSIONER MACKINTOSH: Turning to another matter, I am interested in your comment on the report of Professor Cairncross where he refers to regional problems. I take it you would not look with much hope on any attempt to deal with these regional problems through monetary policy?

SIR DENNIS ROBERTSON: I think it is always a matter of the individual case, and I do not know anything about this particular problem but, of course, this problem which Professor Cairncross is investigating here is rather like a problem that Scotland has at home. I would not say that you cannot use financial methods to help you with these problems. If one is distinguishing between monetary and fiscal, I think your methods have to be fiscal rather than monetary. It would be difficult

to see your banks adopting a very different degree of lending standards, and so on, in different parts of the country. However, I would not throw it out as a matter of principle, and as a point of fact I think in England, when these directives are given by the Bank of England not to lend to this and not to lend to that, there is some exception in what they now call the development areas and they are allowed to lend on things they would not be allowed to lend on in other areas. I think monetary policy, even in the narrowest sense of bank lending policy, can be called into service. I would not say you cannot do anything by it.

COMMISSIONER MACKINTOSH: We have had proposals that tight money should be mitigated as far as some of the Atlantic provinces are concerned.

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER MACKINTOSH: What do you say as to that?

SIR DENNIS ROBERTSON: I would not rule it out as a matter of principle. I mean, if you have made up your mind that the community as a whole is prepared to incur a certain sacrifice for the sake of giving these regions a square deal, then I cannot see why you should rule out any particular method of doing it which helps you get what you want to do.

COMMISSIONER MACKINTOSH: Those are all the questions I have to ask at the moment, Mr. Chairman. Some of the other Commissioners may wish to pursue

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this.

THE CHAIRMAN: Are there any other questions on this point?

COMMISSIONER BROWN: I was wondering, Sir Dennis, if you would visualize these regional policies as being a directive of the central bank or a directive from the political level?

SIR DENNIS ROBERTSON: Oh, I think it must come from the political level with the central bank working in with the governmental policy in this as in other respects. I think it would be very difficult for the central bank to have a regional policy that was not that of the government.

COMMISSIONER LEMAN: I should like to ask Sir Dennis a question in this area of his submission. I gather you feel that population growth in Canada should not be of special concern, and yet these questions of encouraging immigration or discouraging have been a matter of great discussion in Canada from time to time.

SIR DENNIS ROBERTSON: It has, yes.

COMMISSIONER LEMAN: In view of the geographical characteristics of Canada, and the fact that our population density is so low, do you not believe in general that Canada would gain from -- you use the term ---

SIR DENNIS ROBERTSON: A smart rate of growth.

COMMISSIONER LEMAN: Yes.

SIR DENNIS ROBERTSON: Yes, I suppose it

would. I was thinking that you have not got the particular problem that, say, Australia has. I was trying in my mind to compare the motives why people have to have population policies. In Australia there is the racial complication of being a sort of an outpost of a white world in a world that is not predominantly white. You have not got that complication here. In the case of India you have these tremendous explosive forces of population, which it is gallantly trying to control but cannot completely control. It seems to me that as compared with either of those countries Canada has not a tremendously over-riding reason for growing at one pace rather than at another pace.

COMMISSIONER LEMAN: But would you go along with the thought that a smart rate of growth in population and family formations, and so on, is great stimulus to economic activity?

SIR DENNIS ROBERTSON: It is a great stimulus but it carries itsdisadvantages in the end, does it not? In fact, when these countries grow they do not grow all over. I have not got the figures at hand but in Australia an enormously large proportion of the population lives in the great cities, and you have all the problems of urban congestion, and so on, arising. This seems to be so, no matter how big and enormous your country is. Look at the United States, its vast regions, and the enormous concentration of population on its eastern seaboard. If you could spread out your population all over the

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country, well and good, but in the end it seems to result in the large, open-area countries being as congested as little countries like England or Belgium.

I am doubtful of the advantages of very great population. I am talking economics. Of course, if you then think of power and military capacity and all that, and many other things that come in, that is another matter but I am trying to remain on the economic plane. What I am endeavouring to say is that if you do try to grow very fast you get considerable congestion problems and the monetary problem does become more difficult. You get a bias towards inflation.

COMMISSIONER GIBSON: Do you think the monetary policy which does have a bias towards inflation with a purpose of encouraging growth is in effect conducive to the most rapid growth over a long period?

SIR DENNIS ROBERTSON: Not necessarily, I do not think. I still believe that if you desire steady growth over a long period you had better avoid inflation. I would not deny, however, that if you want quick growth you hasten it to some extent at the price of mounting inflation.

COMMISSIONER BROWN: Continuing on this question of growth, Sir Dennis, you distinguish between capital formation and technical progress and indicate that in your opinion it would be a government responsibility to encourage specific types of capital

formation. I gather that this means it would have to be done through fiscal measures rather than in the general monetary policy, and I was wondering in what way you visualize this being done? Would this be by special capital cost allowances and depreciation allowances?

SIR DENNIS ROBERTSON: I am very doubtful how far in a country as developed as Canada it is necessary for the government to lay down the lines of development. If you are dealing with one of these extremely backward, under-developed countries, then you have got to have some kind of government plan for installing what is now called the infra-structure, and you have to have a certain minimum pattern of transport and power in particular before the private enterprise can really function at all. I should have thought Canada was now beyond that stage. You have got your great trans-continental rail, road and air traffic. I would not be at all sure that it is a function of government to intervene very much in the direction of investment, but I am speaking very ignorantly. In so far as the government is trying to do these things then it must, as you say, be fiscal measures, either direct government enterprise in the suitable cases or a system of investment allowances and subsidies in other cases.

COMMISSIONER GIBSON: Mr. Chairman, if there are no more questions in this area, I might go on to another.

THE CHAIRMAN: Yes.

COMMISSIONER GIBSON: Sir Dennis, I should like to ask you one or two questions about the effectiveness of monetary policy and about its relation with fiscal policy and debt management. As regards its effectiveness, in a number of places in your memorandum you refer to its limitations. You do not at any point say just how you think it works. You say that interest rates are not always too effective in their influence on persuading perople to reduce or increase their expenditures. I wondered if you would give us your views on this subject as to how actually effective a restrictive policy works and influences changes in business decisions, and so on.

SIR DENNIS ROBERTSON: I would much rather hear you on the subject than speak on it myself. You probably know, and I am sure that I do not.

COMMMSSIONER GIBSON: Sir, I can assure that we do not know and we would very much like to have your views as between the effect of interest rates and credit availability. Is it the actual changes in cost or availability or is it the expectations of changes in cost or availability?

SIR DENNIS ROBERTSON: I think I am going to be cowardly and say both. The evidence is awfully conflicting, as you know, and I expect you heard a little more here. I have waded through some of the Radcliffe Committee evidence -- I do not pretend to have read it all -- and I cannot help but think that the Radcliffe Committee in my country came to unduly pessimistic conclusions about its effectiveness.

They were dealing with a period in which inflation really got going. There was a tremendous lift. There were increasing prices and increasing profits year by year, and once you have a tremendous upward surge of that sort you cannot expect moderate changes in the bank rate to have very much effect. But, once that inflationary spiral is stopped I should have thought that we had in England reached a position where there was a sufficiently large body of investment sufficiently sensitive to moderate movements in the rate of interest to make some difference.

I do not think you can proceed alone by movements of the rate of interest, and I do not believe that in England we have ever done that. I think long before, when we were on the old gold standard arrangement, it was not only the bank rate movement that did the thing. I think the bankers were always exercising a fairly considerable discretionary power.

Keynes at one time talked about the fringe of unsatisfied borrowers which he said had a chronic existence. The system operated very largely by making that fringe of unsatisfied borrowers

a little greater or a little less. I think you can show that the big industries may be very insensitive to moderate movements, and to availability, but nevertheless there is a whole marginal fringe of transactions which can be affected by these methods.

COMMISSIONER GIBSON: Even small changes?

SIR DENNIS ROBERTSON: Even by relatively small changes.

COMMISSIONER GIBSON: So you would not disagree with the view that Professor Viner expressed yesterday that monetary policy should move gradually and slowly in small doses rather than in sudden jumps, if that is possible?

SIR DENNIS ROBERTSON: Yes, but I think it may have to move in large jumps, and larger jumps than people used to consider. I think the trouble in England in the early fifties was that people were not thinking in terms of big enough jumps. The Bank of England would speak of 5 per cent as being a crisis rate, whereas 5 per cent was not very high for those conditions. It was a high rate for earlier times. It was not until they really began to think in terms of 7 per cent that they could really bite. I think the smoother you can make it the better. There is this metaphor of the motor car that everybody uses nowadays, of keeping one foot on the accelator and the other on the clutch or the brake, but life is not quite like that.

COMMISSIONER GIBSON: The only evidence -- and I am speaking purely personally -- that I have heard and

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COMMISSIONER GIBSON: The only evidence -- and I am speaking purely personally -- that I have heard and

that has impressed me as to just how effective a change in monetary policy is, is that it does work when there has been substantial changes. Both Dr. Holtrop and Lord Cobbold both said that it is when there are big changes in the bank rate and a tightening up of the banking system that things really start to happen, and that you can trace the results.

SIR DENNIS ROBERTSON: Yes. Well, all I can suggest is that the Bank of England let things go too long and too far, and then it had to make substantial changes. If they had been a little readier to make moderate changes more decidedly we might not have got into the position in which we had to raise it to 7 per cent, but I do not know.

COMMISSIONER GIBSON: How about the other way, sir? We have been talking about monetary policy in terms of its restrictiveness.

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER GIBSON: Do you think it is as effective in terms of its expansive effects?

SIR DENNIS ROBERTSON: No. I think you may get into a position of jam as in the thirties when you could go very low without very much happening.

COMMISSIONER GIBSON: You are pushing on the string?

SIR DENNIS ROBERTSON: Yes, you are pushing on the string, and then you have got to have your fiscal policy coming in.

COMMISSIONER GIBSON: This leads on to the question of the relationship of fiscal policy. At several

places in your memorandum you emphasize that fiscal policy has an independent life of its own, and that it cannot just be bent to fit monetary policy.

You do say that fiscal policy can help an upgrade, and you put quite a little emphasis upon that, but you do not say much about what you propose when there is an element of restriction.

SIR DENNIS ROBERTSON: I think it could do quite a lot in the way of running budget surpluses, and so on, and it should do.

COMMISSIONER GIBSON: Do you see fiscal policy as having a cyclical character? Should it be bent that much?

SIR DENNIS ROBERTSON: Yes, I think it can be developed in that direction. As you know, England is now experimenting in that with what the Chancellor calls regulators -- indirect taxes which he is able to raise without going to parliament every time.

The trouble about fiscal policy is that it is so apt to work only at budget times once a year, and be rather impotent in between. I think there is real room for experiment in giving the executive or the legislature -- it depends on the system of government -- more power to vary its tax rates quickly. Mr. Kennedy spoke the other day -- I do not think he has got it yet, has he? -- of power to put down the income tax rate in order to produce a quick effect. He did not say anything about putting it up. Perhaps that might

come later once he gets the power to put it down.

COMMISSIONER MACKINTOSH: After the elections, but not before.

SIR DENNIS ROBERTSON: Once he had the power to put up direct taxes during the currency of the fiscal year then I think his fiscal policy could be very effective.

COMMISSIONER GIBSON: In your memorandum you give the impression that you are rather doubtful about this business of reducing taxes as an expansive weapon.

SIR DENNIS ROBERTSON: I think each party always expects too much of the other. In England the relations between the treasury and the Bank are, as you know, extremely good, but there is always an undercurrent of thought on the part of the Bank that the treasury might have done a bit more, and you might also find an undercurrent on the part of the politicians that the bankers could do a bit more. They are each a little bit anxious to prove an alibi, to prove that the other chap ought to weigh in better. Probably they are both right. I think it is a fair criticism of the present Conservative administration that when they rediscovered monetary policy in 1952, after it had been forgotten for ten years or so, that they expected too much of it. They thought: "This is splendid, we can do everything through the banking system, and we can have a nice easy budget .

In rather the same way, but the other way around, the bankers thought that everything would be quite

easy if only the government would put on such heavy taxes so as to finance all of the capital expenditure of the nationalized industries, and that they would then not have to bother about having to issue treasury bills to finance them. There is a little tendency for each party to expect too much of the other.

THE CHAIRMAN: There is a great deal of talk at times such as we are going through of budget deficits to accomplish the objective of greater employment, and so on. But, there seem to be several flaws in that under the circumstances, and in this country one is that the more money that is put into the hands of the people then the more purchasing power they have and thus greater will be our importation of goods from abroad, particularly from the United States. One of our problems is that our balance of payments is unfavourable, so from that point of view alone there are certain dangers in budget deficits under present conditions.

SIR DENNIS ROBERTSON: I quite agree. I think one has got to be very careful in how one measures these budget deficits. The illustration that I used in my paper was this, that you might have a country like England which for good reasons or bad has decided to nationalize a number of industries. Those industries will require a programme of capital expansion, just as they would have if they were not nationalized. Somebody has got to provide for the expansion of the electricity supply, road and railway transport, and so on. I do not think that just because a country

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has nationalized an industry that it ought, therefore, to expect to pay for the capital expansion of that industry out of taxation. If by the budget deficit you are looking over the whole range of capital and current expenditure taken together, it seems to me quite reasonable that a country which is in that position should have a budget deficit. That is to say, it should be borrowing in the market for part, at any rate, of the capital expenditure of the nationally owned industry.

Your central banker might take the line that that was all wrong; that if the government determined to have these nationalized industries it ought to pay for them out of taxation and not go on to the capital market. That would be extreme. I do not think it would be seriously argued by the Bank of England, and if they did so argue then I would say they were wrong. It would be perfectly correct for a government to borrow in the market for the finances needed to expand its nationally owned industries.

THE CHAIRMAN: That is for the investment in buildings and plant?

SIR DENNIS ROBERTSON: Yes.

THE CHAIRMAN: Well, it would mean, I suppose, that they would have to have a different way of keeping the books?

SIR DENNIS ROBERTSON: Yes, it would be different bookkeeping.

THE CHAIRMAN: Some of the provinces here carry on in that way. In Ontario we always have had

as nationalised an industry that [illegible], [illegible] to expect to pay for the capital expansion of that industry out of taxation. If by the budget deficit you are looking over the whole range of capital and current expenditure taken together, it seems to me quite reasonable that a country which is in that position should have a budget deficit. That is to say, it should be borrowing in the market for part, at any rate, of the capital expenditure of the nationally owned [illegible]

[illegible]

Your central banker might take the view that that was all wrong: that if the government is going to have these nationalised industries it ought to pay for them out of taxes and not go on to the capital market. That would be extreme. I do not think it would be seriously urged by the Bank of England, and if they did so argue, then I would say they were wrong. It would be perfectly [illegible] for a government to borrow in the market [illegible] finances needed to expand the nationally owned industries.

THE CHAIRMAN: That is for the investment in buildings and plant?

SIR DENIS RICKETT: Yes.

THE CHAIRMAN: Well, [illegible], I suppose that they would have to have a different way of [illegible] the books?

SIR DENIS RICKETT: Yes, [illegible]

[illegible]

THE CHAIRMAN: [illegible]

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a capital account and an ordinary account, and generally in the ordinary account there is a surplus, and there is sufficient to provide for a sinking fund and, generally, about a third of the cost of capital investment. Over the years that has resulted in a considerable expansion of the capital debt, but nevertheless it was in a period of expansion, and there was income sufficient to service the debt.

SIR DENNIS ROBERTSON: Yes. Well, that seems to me to be all right.

COMMISSIONER GIBSON: Sir Dennis, you refer to the third sister in this trinity of monetary policy and fiscal ---

SIR DENNIS ROBERTSON: Yes, debt management.

COMMISSIONER GIBSON: You have looked firmly into the future, and you think that debt management should not be influenced by short-term changes. In other words, you suggest that the aims of debt management, whenever feasible, should be towards lengthening the average life of the debt appropriately?

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER GIBSON: But you do not say anything about the cyclical function that debt management might play.

SIR DENNIS ROBERTSON: I do not know much about that. I should think it would have a function, but I would not expect an awful lot from a cyclical point of view. I think the long term is more important, namely, to prevent the debt from getting shorter and shorter simply through the lapse of time.

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SIR DENNIS [illegible]: Yes. Well, that seems to me to be all right.

[illegible] to the third answer in this [illegible] of [illegible] and Fiscal ---

SIR [illegible]: [illegible]

COMMISSIONER [illegible]: [illegible] into the future and you think that such [illegible] should not be [illegible]. In other words, you suggest [illegible] of debt [illegible], [illegible] should be [illegible] average life of the debt [illegible]?

SIR [illegible]: [illegible]

COMMISSIONER [illegible]: [illegible] anything about the [illegible] might play.

SIR [illegible]: I [illegible] about that. I should think [illegible], but I would not expect [illegible] point of view. I think the long [illegible].

[illegible]

[illegible]

COMMISSIONER GIBSON: You would be deliberately shortening the term of the debt as an expansive measure?

SIR DENNIS ROBERTSON: Well, I would not rule out anything if you are really in a jam. I am really ignorant of the history of what happened here. Am I right in thinking that in 1958 there was this lengthening undertaken at a rather inappropriate moment which did make the cyclical difficulties greater than they need have been?

COMMISSIONER GIBSON: It did create some later problems. It is a question of opinion as to how you balance them.

SIR DENNIS ROBERTSON: Yes. What I was chiefly sensitive of in England in the late forties and most of the fifties was that I thought the authorities were being too slow to recognize the change that had come over the capital situation of the whole world, and were too much afraid of being accused of interfering in the market by raising the rate of interest on the long-term debt. I think we went on too long in the forties and the fifties with an uneconomically low long-term rate of interest.

I read with great interest the disputes about this that occurred on the Radcliffe Committee between Lord Cobbold and some of the economists, especially Professor Sayers. Enormous as is my respect for Lord Cobbold I think my sympathies were on the side of the economists. The technicians/said they could not have let the long-term rate of interest go up without spoiling the market, so to speak, on the government debt, and Sayers

SIR JAMES [illegible]

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[illegible]

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[illegible]

SIR DAVID [illegible]: [illegible]

[illegible] of it England [illegible]

[illegible]

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said they
economists. The technicians [illegible]

long-term rate of interest [illegible]

[illegible]

in particular kept saying that they ought to have succeeded in using this weapon of debt management more effectively to counter the inflation. My sympathies there were in favour of the economists against the technicians, but I know how difficult these things are for the technicians.

I think it is very important that the monetary authorities should have their interest policy in line with the underlying facts of the capital market.

COMMISSIONER GIBSON: Sir Dennis, would you care to express a view on the Radcliffe Committee's attitude about liquidity, that it is the whole range of liquidity that matters and that just the banking system itself is only part of the whole picture? I do not know, but maybe it is asking too much. Would you care to express an opinion about that, and say what you think the implications of this view are? If you could, that would be most helpful.

SIR DENNIS ROBERTSON: I think it is perfectly true that there is now a number of institutions which are not commonly called banks but which are having very much the same effect as the banks. I find the Radcliffe Committee often rather irritating about this. They speak of liquidity, but they give one no idea as to how to measure the thing; it is something you cannot measure but it is a sort of feeling, and you have very little idea how to control it.

What it comes to , as a practical question, I suppose, is whether you are going to submit some of these non-banks to the same kind of disciplinary action as you submit banks to. I think it may be necessary to extend the powers of the central bank.

As far as I understand, what happens now, quite recently and perhaps partly as a consequence of the Radcliffe Committee, is that when the governor of the bank has something to say to the ordinary banks he takes good care to bring what he

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has to say to the attention of these non-banks as well. But nothing has been done, so far, to bring them in numerically; that is to say, there is no 80 per cent rule about reserves and no 15 per cent rule about liquid assets. Whether that is going to come or not, I simply do not know.

I still do feel there is a considerable difference between bank money which is a final discharge of a debt and other instruments which are not. What I do not know about this country is how far the deposits in the non-banks are actually used to draw cheques upon and can be used as a means of remittance. It seems to me that if they can be and are being freely used as a means of remittance, then they are virtually banks and ought to be treated as such. It may be an academic difference, but I feel there is a certain difference between a bank account that can be transferred by cheque and one that cannot.

COMMISSIONER BROWN: Perhaps, Sir Dennis, you would be prepared to give us a definition of a bank or banking?

SIR DENNIS ROBERTSON: No. What I was brought up on was to say that there was only one act of parliament in England which defines a bank, and that defines it as a body which performs the business of banking.

COMMISSIONER LEMAN: Sir Dennis, to come back to these near banks. Would you say you would focus your attention mostly on whether these deposits are

chequable deposits -- in other words, can be drawn on by means of a cheque -- or just the fact they can be withdrawn without notice, in effect?

SIR DENNIS ROBERTSON: I was thinking more of the fact they can be drawn on and are useable as a means of remittance.

THE CHAIRMAN: From the point of view of their effect upon the economy, is that really a proper distinction?

SIR DENNIS ROBERTSON: No, I do not think so.

THE CHAIRMAN: They are in a position to supply money at a time when the banking system may be contracted by monetary policy.

SIR DENNIS ROBERTSON: Yes, I cannot get away from that.

THE CHAIRMAN: And that is where they come into conflict.

SIR DENNIS ROBERTSON: Yes.

THE CHAIRMAN: And that is one of our problems.

SIR DENNIS ROBERTSON: Yes. I was interested that the American commission appeared to treat this problem very lightly. I do not know whether they were right to treat it so lightly, but they did -- I thought, probably too lightly. On the other hand, I think perhaps the Radcliffe Committee made too much heavy weather of it, so I am sure you will get it just right.

THE CHAIRMAN: Everybody seems to treat

them very lightly, and everybody seems to be reluctant to take any definite steps to control them. Whether or not it is necessary may be a question.

SIR DENNIS ROBERTSON: Yes.

THE CHAIRMAN: Some of these near banks make use of the banking system.

SIR DENNIS ROBERTSON: Yes.

THE CHAIRMAN: They borrow money and have lines of credit with chartered banks, and their operations might be restricted when the chartered banks' operations are restricted.

SIR DENNIS ROBERTSON: Yes. That is to say, it is a misuse of language, is it not, to say they are taking deposits away from the banks, because they are themselves keeping deposits with the banks? But it does not follow they are not taking business away.

COMMISSIONER BROWN: Dr. Holtrop suggested that one measure of the point at which these near banks became a factor was when their velocity of turn-over became unity for a year; in other words, when deposits turned over a minimum of once in a year. Would you care to comment on this as a definition or as a picture of when they become a factor?

SIR DENNIS ROBERTSON: I think it is rather arbitrary. I cannot see any reason for fixing it at a year, so to speak.

COMMISSIONER BROWN: Could you possibly

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COMMISSIONER [illegible]: Could you possibly

suggest to us some measurement that might be used?

SIR DENNIS ROBERTSON: No, I do not think I can because once you get into this realm of liquidity, as distinct from money, it is an immeasurable thing and it is what you feel about it.

The Radcliffe Committee seemed to me to exaggerate it, because they pointed out that any individual feels liquid if he has something that he thinks that he can realize; and they made his liquidity depend not only on all sorts of property holdings, but they said that you feel liquid if you think you are going to sell your goods and have an incoming stream. But once you get into that sort of region you have something you cannot measure at all, and you are liquid because you feel happy. I should have thought that if the central banking system had a pretty tight grip over the supply of money, in the old-fashioned sense, including the deposits of the chartered banks, the commercial banks, it would be very far on in having a grip on the whole system.

COMMISSIONER GIBSON: You do not think the ownership of a short-term instrument, like a treasury bill, gives the same feeling a bank deposit does to an individual businessman?

SIR DENNIS ROBERTSON: It may to an individual businessman, but if everybody feels they can assume they can turn their liquid assets into hard cash, somebody, in the end, finds he cannot, and then you have some very good

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bankruptcies.

THE CHAIRMAN: When do you have liquidity and when do you not have liquidity? You may have claims against the bank; many people have claims against a bank in the form of deposits.

SIR DENNIS ROBERTSON: Yes.

THE CHAIRMAN: They will be used and drawn upon at a certain rate; the level may not change very much over a period; and then, all of a sudden, there is a run on the bank. Do you say, once there is a run on the bank, there is an increase in liquidity, and that there was not the same amount of liquidity during the period when they did not exercise their right? Did they not have liquidity at that time? They could have exercised their right. Is the borderline at the point where people make up their minds to make use of these claims that they have? Is this always a matter of the mind of a person, or is it something else?

SIR DENNIS ROBERTSON: That is what it seems to be, but if they all make up their minds at once they want to use it, they will not be able to.

THE CHAIRMAN: So there is no liquidity at any given time?

SIR DENNIS ROBEERTSON: There is a sort of assumption at the back of it that the banks will not be allowed to fail. I do not know what the law is here, but I would have thought that in the United States deposit insurance has gone a long way to make a difference as to what is a bank and what is not.

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COMMISSIONER GIBSON: This takes us back, really, to how does monetary policy work. How does it influence this feeling of liquidity which, in turn, results in decisions? Would you say a word or two about your views as to how changes in interest rates affect savings?

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER GIBSON: We have not discussed this yet, and I do not think it is covered in your memo.

SIR DENNIS ROBERTSON: I think it is a very unknown subject, really. There are people who think it does not have any influence at all. I am old-fashioned about it, and I should have thought that, on balance, a rise in the rate of interest did stimulate saving or discourage dis-saving, which may be equally important nowadays; and that when the capital value of their holdings is going down a bit they would pull in their expenditures. You can say that if the rate of interest goes down people will work and save harder, because they will have a particular goal in their mind, and they will work a bit harder to attain that goal. But I would say, on balance, the old-fashioned view is true that by a rise in the interest rate, by one route or another, you do stimulate saving.

COMMISSIONER GIBSON: Do you think that the low price of fixed interest securities entices savers, because of a capital gain that might be involved?

SIR DENNIS ROBERTSON: I think people are influenced in their expenditures by that.

COMMISSIONER GIBSON: In other words, if you can buy securities at below par, because interest rates are high, does this give a strong added incentive to people to buy securities, with a veiw to making a tax-free profit? Is not that true of the United Kingdom?

SIR DENNIS ROBERTSON: We have a new law about this, but it has not come into force yet, and we do not know quite how it is going to operate. I would rather not speak on the tax side of it; I do not really know.

COMMISSIONER MACKINTOSH: Would it be fair to say that a shift in the interest rate in the short run rather brings about a shift in assets and, in the longer run, will have an influence on savings? In other words, on a short run it is more likely to have an influence on the way in which savings are held than in the total amount?

SIR DENNIS ROBERTSON: Are you distinguishing between the short rate of interest, and the long?

COMMISSIONER MACKINTOSH: No, I am distinguishing between the short-term effect and long-term effect of a movement in interest rates.

SIR DENNIS ROBERTSON: I do not think I can answer that question.

THE CHAIRMAN: We will now recess for 15 minutes.

--- Short Recess.

THE CHAIRMAN: We will now resume.

COMMISSIONER GIBSON: I might continue for a moment, Mr. Chairman.

I wonder, Sir Dennis, if you would say a little more about how you think this feeling of liquidity or, conversely, illiquidity affects decisions to spend and save?

SIR DENNIS ROBERTSON: Perhaps, Mr. Chairman, the rest of the Commission would like to hear the story of the danger of the use of physical metaphors. There was an occasion when the French banks had been in a lot of trouble and they got over it and things were looking better. I think it was the correspondent for the Economist newspaper who gave an account of this situation and ended up with these words, "In fact, the banks are in a thoroughly solid and liquid condition." You can make of that what you like. It is a very imponderable thing, that notion of liquidity.

I would come back to saying that if the central bank has got a real grip on the more concrete elements in the situation, on the money as we understand it in the sense of bank deposits and notes and so on, the other thing, the liquidity, is tied to that as it were by sort of a string and if you really can tighten up on the visible things, the bank deposits, and so on, that is going to affect the actions of everybody else in time; that they will become aware that these instruments that they hold -- bills, or whatever it may be -- are not going to be so awfully easy to get rid of at the very moment that you want to and the feeling of caution

will spread. Isn't that so? You who are in the business know very much more about it than I do as to how it really does work.

COMMISSIONER GIBSON: Is this because interest rates are rising?

SIR DENNIS ROBERTSON: I think this has a lot to do with it.

COMMISSIONER LEMAN: It is the psychological reaction to a change?

SIR DENNIS ROBERTSON: Yes, it all helps to pull people up, but I can't go much further, I am afraid.

COMMISSIONER GIBSON: If there are no more questions in this field, I would just like to ask you a question in the area of wage policy, profits policy.

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER GIBSON: And which you discussed at some length in your memorandum.

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER GIBSON: And indicated some of the difficulties and limitations of attempts at direct actions in this area. We heard from Professor Lundberg from Sweden last week and he expressed quite an interesting view in this area; he said that his view was that wage policy should be designed to make wage rates as uniform as possible for the same kind of work, and he reduced the differentials between different kinds of work and between skilled and unskilled as much as possible, his point being that by producing a more equally uniform wage scale there was a greater

incentive for the inefficient and declining industries to decline and become unable to go on, and that these people were more readily available in expanding industries but, by the same token, you wouldn't have to pay quite as much because you have a more or less level wage scale.

Now, it would be very interesting to know what you think about this kind of approach.

SIR DENNIS ROBERTSON: Yes. It is a little bit of a surprise to me, I think.

COMMISSIONER GIBSON: I may not have expressed it altogether accurately, but perhaps Dr. Mackintosh will verify that.

COMMISSIONER MACKINTOSH: Well, I think that is accurate except that he added another rather surprising element, that in maintaining level wage policies they have the strong support of the unions, who would rather see unemployment develop in a declining area than see it mitigated by a reduced wage rate, and I rather gathered that this threw it into the government's lap and not into theirs.

SIR DENNIS ROBERTSON: That may be. This again is a little bit of a surprise.

COMMISSIONER GIBSON: Because he said they had great confidence in the government's employment policy.

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER GIBSON: This is rather the reverse of a kind of classical approach to this problem, as I understand it, and I wondered what your reaction

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would be.

SIR DENNIS ROBERTSON: My own feeling is that you want to have the differentials to some extent between the advancing industries and the stationary ones in order to promote or to attract a flow of labour to the advancing industries. I think it is awfully difficult not to get mixed up here between the productivity increases and profitability.

There has been a lot of talk in England about the danger of wages outrunning productivity, and there has been a tendency to think that you could allow the wages in each particular branch of industry to rise to the full extent of the increase of the productivity in that industry, and some of us have been very insistent on saying that is not right because some industries are inherently more susceptible to technological progress than others, and if you allow the progressive industries to raise their wages to the full proportion of the increase in productivity, then you will find that your general wage level is going up because there are other industries which cannot increase their productivity -- government services for instance -- who cannot produce figures of measurable increases in productivity, and they will not allow themselves to be left behind, so we have the whole level driven up. So, the doctrine in England is that what you want to achieve is a wage level rising in proportion to the average rise in productivity and not going up out of proportion in the more productive fields, but whether

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this is consistent with Lundberg or the opposite; I can't quite see at the moment.

You see, I think you have to have a compromise between this doctrine -- the general wage level rising according to the average rise in productivity -- and the need for a certain amount of stimulus to labour to move to the productive activities by allowing a certain amount of increase above the average in an industry where not only productivity is increasing fast, but profitability also. Take the case of agricultural industries: if productivity increases these, then it doesn't mean you want to try to attract people into them; it means you want to push them out. But there are other cases which are both susceptible to productivity increases and also are profitable and able to pay high wages, and you might want wages there to rise faster than in the average industry in order to draw labour in the right direction.

I was rather afraid of Dr. Lundberg ironing out these differentials before they have had their designed effect; to draw labour in the direction in which it is needed.

COMMISSIONER MACKINTOSH: The impression I got was that he depended more on the push than on the pull.

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER MACKINTOSH: And combined with

his analysis was the great emphasis on an efficient placement service training and re-training workers for new industry?

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER MACKINTOSH: And I think it may have been partly political in that if these things are on the doorstep of government, they have to do something about them.

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER BROWN: Would it be fair to say that Dr. Lundberg's ideas were that unemployment was more effective at increasing labour mobility than lower wages?

SIR DENNIS ROBERTSON: Yes, I think that is it. It is pretty difficult politically, I should have thought; the government will be accused of creating unemployment.

COMMISSIONER LEMAN: Well, except that the labour leaders were in accord with it.

SIR DENNIS ROBERTSON: Exactly, yes.

THE CHAIRMAN: But, in fact, my recollection is they didn't have any substantial unemployment?

COMMISSIONER MACKINTOSH: No, they had had --

THE CHAIRMAN: A continuous high employment period for a very long time.

SIR DENNIS ROBERTSON: Yes.

THE CHAIRMAN: Which makes a difference.

SIR DENNIS ROBERTSON: Which makes a difference, and we have had, of course, very high employment over a very long time.

THE CHAIRMAN: And a very strong demand for their export production.

SIR DENNIS ROBERTSON: Yes. I think this is your great difficulty here, of having this rather high unemployment percentage together with the adverse balance; managing these two things together is very difficult.

COMMISSIONER BROWN: Doesn't the size of the labour force come into that picture because this has been the situation in Sweden, the labour force hasn't been increasing at the same speed as ours?

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER GIBSON: Do you think having the wages policy means that you have more effective control over, or you are likely to be more effective in achieving your aim of price stability, or less effective? You said a moment ago that the aim in Britain was to keep wage increases to the average increase in productivity?

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER GIBSON: This would mean in fact that there probably would have to be some annual increase in the cost of living type index because the services element would rise along with the wages in the goods producing industries?

SIR DENNIS ROBERTSON: Well, the idea I suppose would be that you wouldn't allow that; that your wages will rise a bit and the price of services will rise a bit, but to balance that you are having an actual fall in the price level of the highly mechanized industries.

I say that this is the idea, because none of this is happening at present and it is very difficult to be sure it will happen, but the official objective I think is that you should have prices falling in the industries where productivity is increasing fast, and then that balanced out against the rise of prices of services in the service industries, so that the average index number is more or less stable.

COMMISSIONER GIBSON: If you have a consistent wage policy of this kind, you suggest this may lead to the necessity of a profits policy?

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER GIBSON: How do you work out the profits policy?

SIR DENNIS ROBERTSON: How indeed?

COMMISSIONER GIBSON: It is very puzzling.

SIR DENNIS ROBERTSON: I always have been very sceptical about it because, whatever you do about wages, it seems to me not to be desirable that you should have a uniform level of profits as between industries.

If you are going to have a profit enterprise system at all, it seems to me to depend on different levels of profits in different industries in order to guide resources in the right direction and I don't think our people have gotten anywhere yet -- as far as I can see -- towards a clear profits policy.

THE CHAIRMAN: How would it be enforced?

SIR DENNIS ROBERTSON: All you can do, I think, is just to have taxation on profits, of course, and you can have limitations on dividends, but that again seems to me extremely difficult as a long-range policy. In an emergency you can get people to conform to a dividend freeze, but I don't believe you can as a long-range thing unless you are going to have a complete nationalized system.

THE CHAIRMAN: As to the rise in the wage level of the services industries, what is the cause of that? Was that not be due in part, at any rate, to demand for a certain type of skill, the supply of which is short for the time being? The service industries today are engaged in activities which, some years ago, were not contemplated at all. It is a different type of service industry from the old fashioned service?

SIR DENNIS ROBERTSON: Yes.

THE CHAIRMAN: And it requires a certain type of personality and skill to do it. Would it not be the result of the natural forces at work, supply and demand, to raise these wages?

SIR DENNIS ROBERTSON: I think if you want to recruit all government services, particularly, you have got in the long tun to pay rates which are sufficiently attractive to get the high-grade labour from productive industry. That, of course, has been our government's difficulty at home. They started with this policy and the only place they could enforce it was in the government service and it resulted in a great deal of unrest and injustice inevitably, unless and until the private industry is doing the same.

COMMISSIONER MACKINTOSH: In speaking, Sir Dennis, about the possibilities of a wages and profits policy there is a bit of history to this in Great Britain in the terms of the Cohen Committee.

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER MACKINTOSH: And later in the "guiding light," and so on. Would you care to expound this to us? We know a little about it but we should like to know more.

SIR DENNIS ROBERTSON: I should like to if I am able to. I do not know quite how far to go back. If I can go back to 1957 --

COMMISSIONER MACKINTOSH: That does not seem too far.

SIR DENNIS ROBERTSON: I go back to then partly because that was the first great credit squeeze

which was effective entirely, and it happened to coincide with the appointment of this little body under the chairmanship of Lord Justice Cohen, of which I was a member for a time. We produced a report which was spat upon by everybody, and on the whole we backed the Thorneycroft measures as being necessary under the circumstances, and we expressed the hope that the effect of this curtailment of demand would work through onto the labour market and take some of the steam out of the cost push and the upward thrust of wages which was going on. For the moment I think we were right in that in 1958 a good deal of the steam did go out of this push. But then that did not go on. In 1959 the government and the authorities thought they were safe in opening out again a bit, but unfortunately I think they opened out a bit too far.

If I am going to attribute blame I think it was partly due -- and this is hindsight -- to the budgetary policy that was too optimistic and then partly that our friends the bankers through various kinds of ways induced the public to spend money which they had not got. The bankers and the government blamed one another over it, but anyway we got launched again in a great upward movement in 1959 and 1960 and had to do the thing over again with the 7 per cent bank rate in 1961. It does seem that demand control can be effective up to a point, but as soon as we were back this push business started growing again so the government was determined at this time to introduce some kind of what they call a wages policy, and when Selwyn

Lloyd became Chancellor of the Exchequer he announced his intention of setting up a body which was going to try to control to a certain extent the course of investment in government industry and private industry, and also to produce an income policy. He hoped that the trade unions would join this body and that we would get some kind of a concerted investment and income policy. The trade unions took many months to make up their minds whether they would come into this scheme and in the end they decided they would, and there was a strong and very excellent trade union representation on this new body, which is called the National Economic Development Council, but unfortunately the price of that was that this body must not consider wages. It can consider everything else under the sun, but it was quite clear that the trade unions were not going to allow it to consider wages. In any event, that body is pursuing its course. It has a good staff and is trying to get all kinds of information from different industries. I am sure it will do a lot of valuable work, but it does not look like being able to touch the wages policy.

Only a few weeks ago the government announced there was to be another wheel. The National Economic Development Council was the fifth wheel but now we are to have a sixth as well and it will be called the National Incomes Commission. Nobody yet knows who is going to sit on that or what in the world they are going to do, but they have to take over this income policy which the National Economic Development Council

was originally supposed to take over, but which it has been forbidden by the trade unions to touch. So, that is where we are at the moment. When I was finishing off this memorandum it just happened this new body was being set up, and I feel extremely uncertain now as to how all this is going to work out and whether it is possible to get this effective control over the general level of wages, because all problems remain. The only very hopeful thing that has happened is that the Trade Union Congress sees that the ball now looks like falling in their court and they have set themselves to study the matter and they are going around Europe to see what is going on in Sweden and Holland and other places. They have a very remarkable man now who is general secretary, Mr. Woodcock, and possibly something in due course will happen, but what I do not know. I do not think our wages policy is yet in a condition where one can recommend it to other countries as being something which is an obvious success. It is very experimental.

COMMISSIONER MACKINTOSH: How do you feel about this idea of the government through consultation trying to establish a wages policy? Lundberg was very insistent that the Swedish government did not intervene in this. He put a great deal of stress on the highly sophisticated civil service, so to speak, which the trade unions themselves had.

SIR DENNIS ROBERTSON: Yes. There is no doubt they are very different from Britain. They are much more centralised.

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SIR DENNIS ROBERTSON: Yes. There is no doubt they are very different from Britain. They are

COMMISSIONER MACKINTOSH: On this continent a very frequent result of government intervention has been a kind of compromise concession.

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER MACKINTOSH: Rather than any kind of verdict on the fact of the case.

SIR DENNIS ROBERTSON: Yes. I do not envy the new body in England. They have a very difficult task. To me it is not quite clear whether they are going to be asked to settle individual wage questions. I think they are. The government is going to be prepared to refer particular disputes to them. We have already got the most elaborate system of arbitration in particular industries, and that is one of the difficulties, that arbitrators are very determined , that they will not be dictated to by government, and they have been showing their independence of the government in the past few months by giving awards in the government industries which is more than the government is quite prepared to pay. So that the new body has to discipline the arbitrators as well as disciplining the employers and trade unions. It is not going to be an enviable job.

COMMISSIONER LEMAN: Is it your conviction, sir, that a proper monetary policy, coupled with a proper fiscal policy, ought to do the job, and that you need not end up with these six, seven and eight wheels?

SIR DENNIS ROBERTSON: I can say that was my hope when I was sitting on the Cohen Commission. I

felt that if the government and the banking system kept things on the right line the thing would work through onto the labour market. As I say, up to a point in 1958 we were justified. If somebody says, "Well, that is all right for the moment but when the thing bounced back again you had the old situation appearing, that as soon as you got the production index moving up a bit and everybody cheered up a bit, you had the wage push again." -- in answer to that I would say I am afraid it was so.

THE CHAIRMAN: To what extent is the government employment of personnel responsible for the wage push? You have mentioned that before and pointed out that there is no increase in productivity in ordinary government employment.

SIR DENNIS ROBERTSON: There cannot be, in a sense. Your measures are very artificial.

THE CHAIRMAN: So that government employment has a tendency to increase and it is now on a very large scale. How much would you attribute to government employment alone as a cause of this?

SIR DENNIS ROBERTSON: I do not think it would be very much, for I think hitherto in England the rule has been that the government scale has got to be comparable to the nearest kind of analogous work in private industry, and when the government was relatively small that, of course, was a good rule and workable. I think it is still the right rule; that is to say, that the government has got to pay rates which will attract the requisite kind of labour which is not

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only clerical labour but all kinds of semi-scientific labour. It has got to be able to recruit and you cannot go on with what we have had the last year, the government using its power as an employer to keep the government rates down below the rates obtainable for comparable work in private industry. The government would simply cease to be able to recruit in that case in the end.

THE CHAIRMAN: Yes, but then the productivity of the government employee does not increase very much.

SIR DENNIS ROBERTSON: No.

THE CHAIRMAN: He is doing exactly the same work as he was doing before the increase of wages, whereas the employee in industry is in a different position.

SIR DENNIS ROBERTSON: He is in a different position, not necessarily through any merit of his own --

THE CHAIRMAN: Oh, no, no.

SIR DENNIS ROBERTSON: -- but through the advantage of technological and capital equipment.

THE CHAIRMAN: If the average, as you have suggested it should be, is an average over the whole rather than an increase in the more productive industries alone, that might solve the problem.

SIR DENNIS ROBERTSON: That would perhaps solve the problem if you could make it effective.

COMMISSIONER LEMAN: You cannot force all

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SIR DENNIS ROBERTSON: [illegible] different position, not necessarily [illegible] own --

THE CHAIRMAN: No, no, no.

SIR DENNIS ROBERTSON: -- but in math the [illegible] of technologists and applied [illegible].

THE CHAIRMAN: If the [illegible] you have suggested it should be, is an average over the whole [illegible] in the [illegible] industries alone, that might solve the prob[illegible].

SIR DENNIS ROBERTSON: [illegible] the position if you could [illegible]

government employees to wear cassocks.

COMMISSIONER BROWN: Sir Dennis, I wonder if we might change the direction of the discussion a little bit and get back to some of the techniques of monetary policy.

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER BROWN: I should like to get your impressions on bank rate and the different ways in which it is effective. I rather gathered that you are not entirely happy with the rigidities that exist in the English system?

SIR DENNIS ROBERTSON: Yes, I think they may be too rigid; that is to say, there are all sorts of reasons now why the central bank may want to operate a bank rate, largely international reasons, and it may be rather a nuisance, and the advance rate, and so on, is linked so rigidly to the bank rate. I think there has to be some connection between all these short rates. Clearly they must broadly be in the same direction, but I think possibly this very rigid rule by which the advance rate is one per cent above the bank rate, or whatever it is, and the deposit rate is 2 per cent below, and all that, has become a bit too rigid in England.

I stuck my neck out a bit about the Canadian rate, which frankly I do not understand. It seems to the outsider, even now that it has been altered, to be rather queer, this arrangement by which for the market, though not for the bank, the effective bank rate is automatically governed by last week's treasury bill

rate. I may be quite wrong about that. If it works all right it works! I should have thought that it would be desirable the bank rate be a bit more of a symbol, and definitely fixable by the central bank at its own judgment for all purposes. As I understand the new plan it is that it is fixable by the central bank with regard to the rate charged to the chartered banks but is still on this automatic basis for the rate charged to the market. Is that right?

COMMISSIONER MACKINTOSH: Yes.

COMMISSIONER BROWN: Yes.

SIR DENNIS ROBERTSON: I must not ask you questions, I know, but --

COMMISSIONER MACKINTOSH: As I understand it, in London the clearing banks come into the Bank of England through the bill market.

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER MACKINTOSH: With the bill brokers as the intermediary?

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER MACKINTOSH: So that in leaving the flexible rate for the money market they have not left a channel through which the banks can come into the central bank?

SIR DENNIS ROBERTSON: No.

COMMISSIONER MACKINTOSH: I should think they are properly influenced by the fact they have been nursing a money market?

SIR DENNIS ROBERTSON: Yes.

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it?

SIR DENNIS ROBERTSON: Yes. It is obviously a very technical point that one outside cannot really judge.

What I think is important is that it should be recognized that the central bank can and should, up to a point, control the rates of interest, not only in the short range but in the long range; that it cannot plead an alibi. It has got to be careful to fix rates which are not out of harmony with the underlying conditions in either the short market or the long, but I have noticed some suggestion in the literature that seemed to me to be a heresy, that the central bank was not really concerned with money rates but only with the supply of money. I think it is inevitably concerned with the rates, and must take responsibility for fixing them.

COMMISSIONER MACKINTOSH: I can see no other way by which they can regulate things short of formal rationing.

SIR DENNIS ROBERTSON: I agree.

COMMISSIONER BROWN: Is there possibly a slight difference in the effectiveness of the bank here, in the sense that the Bank of Canada also enters the bill auction, which is something the Bank of England does not do. It is dealing with bills during the week, and actually enters into it on the auction day.

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER BROWN: Does this change the picture for you at all, or had you been taking that into consideration?

SIR DENNIS ROBERTSON: I think I did know that. I thought it would be better to have a single

published rate applied to everybody, but I would not press it at all.

COMMISSIONER BROWN: In that connection I am sure we would all like to have your thoughts on whether it is effective as an operative rate even though it is operating in only a small part of the market directly, or whether it is effective in the sense of having a psychological effect?

SIR DENNIS ROBERTSON: I thought it would have more of a psychological effect if it was definitely decided and announced by the central bank, instead of there being a mechanical calculation on the last week's average. If you wanted to have a psychological effect then I think it ought to stand out as something which the bank has decided after considering all the circumstances.

COMMISSIONER BROWN: When it was operating as a floating rate it was operating on a fixed differential of a quarter of one per cent in yield.

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER BROWN: What would be your thoughts if it was still a floating rate but that the bank had power to change, and did change, that differential from time to time? For example, supposing it announced that instead of there being a 0.25 per cent differential in yield the differential would now be 0.75?

SIR DENNIS ROBERTSON: That would be another way of doing it, but it seems rather complicated.

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like to ask Sir Dennis a question before you leave this point, if you are about to leave it.

COMMISSIONER BROWN: Please go ahead.

COMMISSIONER LEMAN: I was wondering, Sir Dennis, if you have some ideas of the means that could used in England to reduce this rigidity in these differentials, and which you feel is a little unfortunate.

SIR DENNIS ROBERTSON: I do not know. It is awfully convenient that everybody does the same thing at the same moment.

COMMISSIONER LEMAN: You have not thought of any tricks?

SIR DENNIS ROBERTSON: I have not thought of any tricks, no.

COMMISSIONER MACKINTOSH: Perhaps you adopted a non-decimal system to destroy the percentage.

SIR DENNIS ROBERTSON: Yes. It may be, of course, that all this business of the bank rate being a symbol is a bit out of date. In a sense it all dates back to the time when the Bank of England would not speak to anybody. It was in an ivory tower, and nobody dare go near it, and the only way it could communicate was by this curious system of flashes. That has now long ceased to be the case. It is explaining all the time what it is trying to do.

But now and again you are afraid people might think: "This is a green light", and it is not really green at all, and by the time you have explained it away people are more muddled than they were before.

COMMISSIONER BROWN: That ties in with a question I was going to ask on this, and that is: Is it more effective in one direction than the other, and to what extent is the bank, in announcing its rates, inhibited on the downside? In other words, suppose the rate goes from 5 per cent to 7 per cent, and then at 7 per cent it has its effect and the bank wants to ease up a little bit without making it too obvious ---

SIR DENNIS ROBERTSON: Yes, that is where the difficulty does begin, I think. You go down to 6 per cent, but you say: "You must not think everything is all clear". That is all right, but you have got to explain that. I mean, this system of flashes does not work unless there is somebody there to tell you what the flashes mean.

COMMISSIONER BROWN: Now, if the bank rate is used to operate on the long-term future of the economy then to what extent is it used, and does this mean that changes should be made only infrequently?

SIR DENNIS ROBERTSON: No, I think they should be made fairly frequently. It ought not to be such an event when the bank rate goes up or down a half point, or whatever it is.

COMMISSIONER BROWN: In other words a little but more frequently rather than these drastic moves ?

SIR DENNIS ROBERTSON: Yes, in the hope that you will not have to make the drastic moves, but I think it is important to make them if they ought to be made. As I have said, I think the Bank of England on the whole was too slow in making them rather than too quick in the 50's.

COMMISSIONER GIBSON: With respect to the question of the bank rate being a signal, Sir Dennis, is there not a danger in having the signals taken too seriously and making them too clear? The market results from people having different views, and if everybody moves in the same direction whenever there is a signal ---

SIR DENNIS ROBERTSON: Then you may get a landslide?

COMMISSIONER GIBSON: Yes, and perhaps defeat the very purpose you had in mind which was a gradual change and not a too abrupt one, and so on.

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER GIBSON: We have heard much difference of opinion as to whether the signals should be very clear or not, because if they are very clear there will be much more confidence that the purpose of the signal will be realized.

THE CHAIRMAN: Perhaps you need something in the nature of a Delphic oracle.

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THE CHAIRMAN: Perhaps you need something in the nature of a Delphic oracle.

SIR DENNIS ROBERTSON: It is awfully difficult. I think on the whole the modern tendency of the Bank of England to explain itself is very good. I think the late Governor was very good about telling us a bit more of what was in his mind.

COMMISSIONER BROWN: Is the important thing with changes in the bank rate the change in the cost of money?

SIR DENNIS ROBERTSON: For some people I believe that is still important. For other people -- the old MacMillan Committee that sat years ago had a phrase about that which proved to be a good one, and it was to the effect that what starts as being an alteration in the cost of money ends up by creating an alteration in the demand for money. There are some who are not directly affected by the cost, but who are affected by the changes in demand from people who were affected by the cost.

THE CHAIRMAN: That was the MacMillan Committee in England?

SIR DENNIS ROBERTSON: Yes, in 1931. I should have thought that was still true. Even borrowers who were not themselves affected by the cost would feel the draught from people who were affected by the cost.

COMMISSIONER BROWN: Do you regard the bank rate as being more important in its effect on the short-term rate, or in its rippling effect

that it causes on the long-term rate?

SIR DENNIS ROBERTSON: Mainly on the short-term rates, but I think -- in this I agree with the Radcliffe Committee -- that the central bank has got to take some sort of a view in the long-term rates as well and not be afraid to try to influence them.

COMMISSIONER MACKINTOSH: You agree with that?

SIR DENNIS ROBERTSON: Yes, I agree with that. I think in the old days it was said that the bank was only concerned with the short-term market, and so on, but now with the immense volume of outstanding government debt, and so on, it is inevitably in the market, and in the long market as well as in the short market. It cannot get out of it.

COMMISSIONER BROWN: In other words, its open market operations should be right through the spectrum.

SIR DENNIS ROBERTSON: Yes, I think so. I see no certain gain in confining it to the short.

COMMISSIONER BROWN: Those are all the questions I have on the bank rates. If the other members of the Commission have no further questions I would like to ask you if you would care to elaborate on the suggestion that you made that you had some thoughts on the possible control of consumer purchasing -- hire-purchase?

SIR DENNIS ROBERTSON: Well, I think it is a weapon which under modern conditions monetary

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SIR DENNIS ROBERTSON: Well, I think it is a weapon which under modern conditions monetary

authorities cannot do without altogether. How far it is a weapon for them, and how far it should be exercised as a weapon by some other organ of government, I do not know. I think that probably varies from country to country.

In England it is partly administered by the Board of Trade -- the terms of hire-purchase -- and that seems to have worked all right as long as the central bank and the Board of Trade are working in harmony, but whether there is any particular advantage in that, or whether it should be the responsibility of the central bank entirely, I have no views. But, I think it is such an important element in the whole situation now that it must be one of the things that the government in the broad sense is prepared to operate on. I think it is not at all easy. It is easy to shoot beyond the mark with it, and the industries that are affected by it do not like it at all.

COMMISSIONER BROWN: Part of the problem here in that respect is that there are corporations borrowing in that field which are not dependent upon the Canadian banking system for their resources.

SIR DENNIS ROBERTSON: Yes. Are they not dependent at all, or only partially dependent?

COMMISSIONER BROWN: There are certain subsidiaries of American concerns.

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER BROWN: Does this enter into the picture at all in England?

SIR DENNIS ROBERTSON: The banking system went into the hire-purchase field in 1959 when it got free -- a bit too much, I think, but in some cases they were quite successful. I should have thought whether they were independent of the banks or not this was a reasonable weapon of control. I am thinking in terms of the length of the period and the proportion of down-payment, and so on. I think it is a weapon that governments have got to learn to handle, even if it is a very awkward one.

COMMISSIONER BROWN: It would have to be done through the medium of specific controls on their operations?

SIR DENNIS ROBERTSON: I think you would probably want both things -- both a power of directing the banks to go light on their loans to hire-purchase companies, and also specific directives about the nature of agreements.

COMMISSIONER LEMAN: I am sorry for having to go back to the previous subject, Mr. Brown, but there is still one question I would like Sir Dennis's views on. In this country there has been an argument made that if the monetary authority played with the long rate too easily and the least bit violently they would destroy the confidence of investors in long-term government bonds.

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER LEMAN: I think we have been told there is a bit of feeling in the United States

that for that same reason they would go very lightly on affecting the long rates directly. Do you have views on the validity of this argument?

SIR DENNIS ROBERTSON: I think I said before that our authorities were too much afraid of that in the 40's and 50's; that they would have done better to edge the long rate up more than they did. They were terribly afraid of destroying the market for government bonds, and I expect I should again disagree respectfully with Lord Cobbold over that. I know that he was very cautious of the dangers of destroying the market if the central bank tried to be too active in its bond dealings, but I would have thought that since then they have got it pretty well right in England. They have kept the long-term rate up; it has never been allowed to go down to what it was before in the early post-war period, but at the same time I think they were quite right in operating in the direction of lowering it a bit in the last year or so, and that they are in harmony with the real underlying situation there. It is partly because the inflationary danger has become less that it has been possible to get the long-range rate down a bit without doing violence to the whole position.

COMMISSIONER LEMAN: Are long-term government bonds in England held by a lot of very unsophisticated investors as they are in North America?

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COMMISSIONER GIBSON: Is your view, Sir Dennis, that the central bank should intervene at various levels of the security market, based on the thought that it is an imperfect sort of a market and it needs to be nudged right across the whole range of maturities?

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER GIBSON: The theory of the other approach is ---

SIR DENNIS ROBERTSON: --- that if you operate one end it will gradually work itself out.

COMMISSIONER GIBSON: Yes.

SIR DENNIS ROBERTSON: I should have thought it was too imperfect for that; that it was reasonable to operate all through it.

COMMISSIONER GIBSON: As a general principle and not just at certain times when you have a much stronger reason for intervening at the long end, such as a capital investment boom?

SIR DENNIS ROBERTSON: I think it is more important then, certainly.

COMMISSIONER GIBSON: And aside from changing the bank rate and open market operations controlling the supply of money, would you care to comment on the question of reserve requirements -- cash reserves and secondary reserves?

COMMISSIONER GIBSON: Is [illegible], Sir Dennis, that the monetary [illegible] should intervene at various levels of the [illegible], based on the thought that it is not a perfect sort of a market and it needs to [illegible] the whole range of maturities.

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COMMISSIONER GIBSON: [illegible] rates are not just in certain [illegible] whatever reason for [illegible] such as a capital [illegible].

SIR DENNIS ROBERTSON: I [illegible] important when, generally.

COMMISSIONER GIBSON: [illegible] change [illegible] controlling [illegible] comment on the [illegible]?

SIR DENNIS ROBERTSON: I think you have got to be prepared to have all sorts of different instruments. I do not very much like the present thing we have in England, the more or less compulsory impounding of bank deposits, but I am not prepared to say you can do without it altogether.

THE CHAIRMAN: Is there any effective substitute for that kind of control? Is it possible to visualize doing without that control entirely?

SIR DENNIS ROBERTSON: I should have thought it not possible now to do without it.

THE CHAIRMAN: But it might be considered rather, from time to time, whether the 8% is the right figure. Would there be that possibility?

SIR DENNIS ROBERTSON: I suppose there is that possibility, or you could take that one for granted and consider more monkeying about with the optional 15 per cent of more liquid assets, which is really now the more important of the two here, is it not? It is certainly in England now. The 30 per cent of liquid assets in England is more important than the 8 per cent, or whatever it is, of cash.

COMMISSIONER MACKINTOSH: You spoke of the impounding of reserves. There is a variant of that by which limits are set on commercial bank loans and investments, or deposits, and an excess over that has to be deposited.

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SIR DENNIS ROBERTSON: Yes, it comes to much

the same thing in the end. I would not have any view, really; it depends so much on the particular thing. What I am not clear about is how far your lending system is an overdraft system, like the British, and how far it is a loan system, like the United States. I think our system is very awkward, this business of overdraft limits, because it means that when the central bank wants to tighten up the individual banks are powerless for a bit, as long as they have given these large overdraft limits.

COMMISSIONER MACKINTOSH: Our situation seems to be we did not have overdrafts, but now the banks have issued a statement they will refuse to have overdrafts in the future.

SIR DENNIS ROBERTSON: Oh!

COMMISSIONER GIBSON: I think the system is basically similar in respect to the fact that lending limits are set up, and they are only partly used up. At the present time their authorizations under lending limits are almost twice their actual loans. It is something of that order.

SIR DENNIS ROBERTSON: I suppose that is very much like the British system. It does make it rather unresponsive, does it not?

COMMISSIONER BROWN: You mentioned the use of moral suasion -- I am not sure you used that expression -- as a technique in bank control or bank co-operation. There are some questions about its use in the sense that I think some of the people who are made subject to moral suasion feel that

what they are asked to do should be done more openly and subject to specific authority.

SIR DENNIS ROBERTSON: Yes, I think you can have too much. My expression for it is "ear-stroking". I used to have something to do with mules, and I was always told that with a donkey there are two things you can use, a stick or a carrot. My experts used to tell me there is a third way of managing a mule; that is to stroke its ears, and then it will do anything you want it to. The Bank of England is a champion ear-stroker, getting people to do what it wants without a stick or carrot. But as you say, you can have too much of it, because the good boys do what you ask them to do and the bad boys do not, and it seems a bit unfair. However, you must have some of it, undoubtedly.

COMMISSIONER LEMAN: Mr. Chairman, if I could then turn to a slightly different realm of thought, namely the international aspects of these problems and, more specifically, those of balance of payments, et cetera.

Sir Dennis, I note in your memorandum that you seem to concede that the floating rate of exchange that Canada used in the 50's, for the decade 1950-1960, to quote your words, "probably did no harm to Canada or anyone else." But do you feel this is true only or mostly because during that period the forces were towards a hard Canadian dollar and that if the forces had been different it would have done harm to others or

itself?

SIR DENNIS ROBERTSON: I do not think it would have done much harm to anybody else. I think that between the biggest currencies of the world, the dollar and the pound sterling, it is not a workable arrangement. I think you must have a fixed rate between them. However, I think that other countries can use this variable rate system without probably doing much damage to themselves or anyone else.

COMMISSIONER LEMAN: This is a rather large subject to talk on now, and it has been suggested to me that perhaps we ought to come back to it later and go through it a little more thoroughly then.

THE CHAIRMAN: I think that if we adjourn now and resume at 2 o'clock it will give you an opportunity to relax for a while, before we get into this rather involved topic. We shall adjourn until 2 o'clock.

--- Luncheon adjournment.

--- On resuming at 2.00 P.M.

THE CHAIRMAN: We shall now resume. Mr. Brown has a question.

COMMISSIONER BROWN: Sir Dennis, in discussing credit squeezes you mention on page 28 that you still believe they "can be made to bite over a sufficient range to be very effective," and then you mention, "though they may take rather longer to operate and may require to be furnished with more varied teeth than used to be supposed ..."

Would you care to discuss at all the lags that develop in them and any suggestions you might have about larger and better "teeth"?

SIR DENNIS ROBERTSON: Well, I think we have discussed some of the other "teeth" which are the things like directives, the Bank not relying solely on the interest rate, but also giving directives to the bank as to the directions in which they are asked to cut down their loan, and also this business of immobilizing some of the resources of the banks by special calls or special deposits. That is what I had in mind about "more varied teeth." We do not seem to be able to rely on movements of the rate alone.

As regards length of time, I do not know that one can hope to quicken the thing up any more. We were discussing some of the reasons earlier, under the English system, this business of the unused overdraft margins. Until the customers of the bank have run through their unused margins they are pretty

well impervious to the attempts to cut down; and one has to recognize that this pressure will be rather slower and less automatic than one would like to hope.

COMMISSIONER BROWN: How about the effects on the concept of liquidity which is, of course, a subjective evaluation?

SIR DENNIS ROBERTSON: That is all part of the same story, in a way, in that for a time people will react against this pressure on the banks by going to other lenders, and unless and until the pressure has been kept up for some time it will not really work through on to the other lenders.

COMMISSIONER BROWN: How about the effects of perverse reactions? In other words,when there is a modest move and some people think it foreshadows a greater move later on, will this speed up the borrowing some people go into?

SIR DENNIS ROBERTSON: I should not have thought it was awfully likely. I suppose that for a time you might have, for a short time, a perverse reaction, but when people find a pressure has been maintained they will believe it in the end.

I find that so many of the critics of the Bank's action over the squeeze in England in 1957 seemed to be arguing it was ineffective and that it was very damaging. Perhaps they wanted it both ways, because if it was as ineffective as they said it was, it could not have been as damaging as they said.

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COMMISSIONER MACKINTOSH: I do not know whether you, Sir Dennis, would be willing to express a judgment, but we have talked about various instruments, the conventional ones, bank rate and so on, and some newer and less tried ones. Instead of trying a limited range and finding they do not work, and then later amending the act and trying a more experimental one, do you think it would be sense to give a central bank the widest array of tools possible so that it could use its judgment and experiment rather than repair the list only after failure?

SIR DENNIS ROBERTSON: Yes, I think I would take advantage of the experience of other central banks that have gradually had to introduce measures one after the other.

COMMISSIONER MACKINTOSH: Even though you are pretty uncertain?

SIR DENNIS ROBERTSON: I would give it a good deal of power and alternatives, hoping it will be wise enough not to use them unnecessarily and not to be continually fussing and interfering if it need not.

COMMISSIONER GIBSON: Sir Dennis, my question goes back to the Bank of England's part in the long-term market.

SIR DENNIS ROBERTSON: Yes?

COMMISSIONER GIBSON: I got the impression from what you said this morning that you felt the long-term interest rate had been kept at a rather

artificially low level in the early post-war period.

SIR DENNIS ROBERTSON: That was my feeling.

COMMISSIONER GIBSON: Is that the Bank of England?

SIR DENNIS ROBERTSON: I think it was everybody at the beginning. I do not want to get involved in politics more than I need to, of course, but Chancellor Dalton was famous for trying to get a low long-term rate of interest established, and he failed. However, I think it is true that all over the world bankers and political people alike were trying to carry on with the war-time policy of sitting on the head of the rate of interest for longer than it was sensible. There again, you have to do the best you can in the circumstances, and it would not have done, immediately that peace was restored, to allow free trade in the capital market, any more than in some of the other markets. You would have rocketed rates of interest owing to the capital shortage.

It was inevitable for the time being that there should be control, but I think that everywhere, including this country as far as I understand it, the attempt to keep the level of interest down kept on too long and you got that situation only gradually righting itself.

In England the authorities, whoever they were, either the treasury or the Bank or both or the government, were a bit slow in recognizing that a change had come over the whole set of the capital market as compared with the 1930's when there were very low rates.

COMMISSIONER GIBSON: Later on I have the impression that you thought the Bank of England had tended to keep out of the long end of the bond market and had confined itself perhaps a little too much to the bills preferable or the short term end.

SIR DENNIS ROBERTSON: I think I feel that. But somewhere about 1957, I suppose, it does seem to me that the central authorities changed their practice a bit and became more willing to see the long rate go up, and were not in any great hurry, when there were rather slumped conditions in 1957 and 1958, quite rightly were not in any hurry to let the rate of interest go down, but to keep it on a fairly high general level, but I think since then they have been willing to see it go down. In fact, they helped it a bit to go down and I think they have been justified as I think that conditions have changed; there is not the same acute shortage of capital which there was

a few years ago although there is still, looking at the world as a whole, a great pressure and demand on capital, but yet at the moment the pressure is less than it has been in the near past.

COMMISSIONER GIBSON: Is it your view that the authorities or the Bank of England should not take the position in the longer end unless they have fairly definite ideas on which way the basic trend in the market ought to be?

SIR DENNIS ROBERTSON: I should have thought they ought to have an idea what the basic conditions were, and if they intervened that they should make sure they are in harmony with the underlying basic conditions even if they are against the immediate market conditions.

I can't take the line that the long term rate of interest is an outside non monetary matter which has nothing to do with the monetary authorities. I think that is an impossible line in England, at any rate, and I would have thought here, too.

COMMISSIONER GIBSON: But you feel you ought to assume the basic forces and try and keep in touch with what the market would produce, but not that they should change the rate in a way which would suit their purposes at the time. What I am trying to get at is their sort of philosophy in this.

SIR DENNIS ROBERTSON: I think it has got to be recognized that keeping the rates favourable for the government to borrow, and so on, keeping down the

cost of government borrowing is a secondary thing; it is good as far as you can do it, but the central bank ought not to sacrifice its responsibilities for monetary control to its perfectly natural desire to keep borrowings smooth for the government. I think that is an important point. I can only say that you ought to look at the real underlying conditions of demand and supply of long-term capital and let the rate vary only within limits which are in harmony with that general underlying position. I am sorry to be very vague, but I think all these things are.

COMMISSIONER GIBSON: Thank you.

THE CHAIRMAN: On page 33 of your brief -- actually, the passage starts on page 32 -- you argue that in periods of deflation a fiscal policy should come to the aid of monetary policy?

SIR DENNIS ROBERTSON: Yes.

THE CHAIRMAN: Through increases in government expenditure rather than reduction of taxes?

SIR DENNIS ROBERTSON: I should say either. Both are legitimate. I think I point out that in the old days it would have been thought rather shocking just to do things by reduction of taxation and we thought we ought to have something to show what use was made of it in the way of public works, but that has rather gone by the board, apparently.

THE CHAIRMAN: Then, when you deal with the control of inflation -- and this is at page 30 -- you suggest in fact that fiscal authority should embrace reductions in expenditure and this does imply that taxes

should also be raised.

SIR DENNIS ROBERTSON: Yes, it implies you may require to raise the taxation rates. As I pointed out, there is a certain amount of automatic compensation which takes place through a given rate of taxation bringing in a higher revenue and the expenditure on unemployment benefits, and so on, declining, but I think the automatic compensatory action may not be enough and it ought to be possible to move rates of taxation, direct or indirect, upward or downward, according to the circumstances.

THE CHAIRMAN: Then, there is just one other question. The footnote to page 31 suggests that frequent changes in taxation policy would damage taxation policy.

SIR DENNIS ROBERTSON: I am arguing the other way around here. I think it is all a matter of keeping balance, and I think that fiscal policy ought to play its part, but I think on the part of monetary experts -- including central bankers -- there is sometimes a tendency to expect the taxation system to carry a bigger load than it is suitable for because, as I say, I think there are limits to what you can do in this direction purely from the point of view of preserving economic stability.

Your taxation system serves other purposes, such as acting fairly between different classes and encouraging or discouraging productive enterprises, so you cannot assume you can do everything you would like to ensure stability merely by altering the taxes; your taxation system has too many other jobs as well.

COMMISSIONER MACKINTOSH: It is something more than an instrument in compensatory finance.

SIR DENNIS ROBERTSON: Yes, it has other functions as well.

THE CHAIRMAN: And if taxes were raised and lowered in more or less an erratic manner?

SIR DENNIS ROBERTSON: It would be very disturbing to the tax-paying habit; this is a very rare and precious one!

COMMISSIONER MACKINTOSH: Not as rare as it was!

Could I ask a related question; assuming that tax reduction has been chosen, do you expect this to have its main effect on consumption expenditures or might it act equally on investment?

SIR DENNIS ROBERTSON: It might act on both, I suppose; I suppose if you want it to act on investment expenditures it is better to have this system of mobile investment allowances, and there again the Swedes have got something, haven't they, some kind of voluntary investment reserve? That is what I understood.

COMMISSIONER MACKINTOSH: And for which they pay very handsomely in taxes.

SIR DENNIS ROBERTSON: Yes, in tax relief. I think that these things are worth looking into.

THE CHAIRMAN: We will now go on to the next subject.

COMMISSIONER LEMAN: Just before lunch we

began to talk about international payments, and I believe you told us that the harmlessness of Canada's floating rate policy during the 1950's was due mostly to the fact that Canada was not a very large country and was not a reserve currency country.

SIR DENNIS ROBERTSON: I think that is part of the story, certainly. You are in a position to do things which the pound or the dollar -- the American dollar -- is not in a position to do. Whether you were worried or not, of course, is something else, but I don't think it did anybody very much harm; either yourselves or anybody else.

COMMISSIONER LEMAN: But you were then referring to the past and now you say that this feeling applies to the future also?

SIR DENNIS ROBERTSON: I would say that having now tied it, it will be very difficult to untie.

There are two questions; you are going to have a fixed or a floating rate, and whether, if it is going to be a fixed rate, you think you have the right rate. I think that Canada is now in a healthier position than it was a couple of years ago because the rate is lower, but I think it might have been better to get to that position by devaluation under the Bretton Woods rules than by the way it was done

Anyway, I don't think I would want to go back to the floating rate.

Many of my colleagues would disagree with me. My successor at Cambridge, who has been a great preacher of floating rates in England, would be disgusted, and

Canada has been the only sensible country in the world in his view, and now that she has given it up ...

COMMISSIONER MACKINTOSH: Do you agree that it is one thing to continue the floating rate and another thing to try and re-establish it after there has been a period when it didn't float -- at least, not quite freely?

SIR DENNIS ROBERTSON: I don't know if you recognize the little quotation which I put in about that on page 47. It is Mr. Harry Graham's lines about the little boy who went for a walk in the zoo with his nurse and then ran away from his nurse and the lion came and ate him up, and this was the moral of the tale:

"And always keep a hold of nurse
For fear of finding something worse."

And I think you had better keep hold now or it might be something worse.

COMMISSIONER LEMAN: Nevertheless, you still concede that even for the future, and unless changes come about, we would remain rather harmless to the rest of the world or does it become, in your view, a matter of discipline and setting a good example?

SIR DENNIS ROBERTSON: That is an interesting question. I think from your point of view and everybody else's you had better conform, but I can't prove it.

COMMISSIONER LEMAN: Would you be inclined to concede the thought that having a floating exchange rate in certain respects makes the job of the monetary policy administrators easier for domestic purposes?

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you have one more degree of freedom, and if you tie up your exchange rate you have less freedom.

COMMISSIONER LEMAN: I understand you had something to do with the setting up of the International Monetary Fund?

SIR DENNIS ROBERTSON: Well, I was working on the ground floor in committees, and things. Looking back it is all very hard to know. When we were working on this Bretton Woods thing, I think everybody thought that there was going to be control of capital movements for as long ahead as one could see, and what we were concerned about was to set up a system which would allow the maximum possible freedom of current movement of trade, and so on; it being understood that the world wouldn't be able to afford to allow unlimited swings of capital for short term or long term. That is what has changed and the technicians nowadays say that it is exceedingly difficult to make this distinction -- which runs right through the Bretton Woods articles -- between capital and current movement and that they don't see any way of preventing these big swings of capital between one country and another in the short-term movement and, of course, nobody wants to prevent long-term investment by one country in another, so that the problem which the international set-up has got to solve now is to provide -- to use the same word -- sufficient "liquidity" in the international system so that nobody is unduly inhibited from going ahead if they want to; and it has got to provide some sort of security against all that being upset by these

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SIR DENNIS ROBERTSON: Well, I was working on the ground floor in committees, and [illegible]. Looking back it is all very hard to know. When we were working on this Bretton Woods thing, I think everybody thought that there was going to be control of capital movements for as long ahead as one could see, and what we were concerned about was to set up a system which would allow the maximum possible freedom of current movement of trade, and so on; it being understood that the world couldn't be able to afford to allow [illegible] of capital for about ten or so years. [illegible] I think the world has changed and the technical [illegible] that it is exceedingly difficult to [illegible] distinction --

between capital [illegible] and current movement and that they can't see any way of preventing [illegible] of capital between one country and [illegible] in the short-term movement and, of course, nobody wants to prevent long-term investment by one country in [illegible] that the problem which the International Monetary Fund set-up was [illegible] to solve [illegible] now is to [illegible] -- to use the [illegible] "[illegible]" in the [illegible] national [illegible] as [illegible] nobody is quite sure [illegible] [illegible] [illegible] [illegible] [illegible]

big swings of capital movement -- first against sterling and later against the dollar, and that is what they are putting their heads together on and at the very moment our Chancellor -- I don't know whether it was yesterday or today -- he is supposed to be talking about this, but whether our ideas and the American and the Continental ideas are sufficiently in harmony with one another to take effective action, it is very hard to see at the moment. One hopes they are. It is more difficult than we thought at Bretton Woods because we did think then that you could draw a working line between current transactions and capital transactions which would be possible to administer, and this is what the technicians believe is almost an impossibility now.

COMMISSIONER LEMAN: Quite a few countries that belong to the I.M.F. still have control over long-term capital movements?

SIR DENNIS ROBERTSON: Yes; they have got control over them, but how effective they are, I do not know.

COMMISSIONER LEMAN: What I wanted to ask you, Sir Dennis, is this: After the passage of these years and the somewhat changed position compared to the time when this was set up, are there now certain changes that you feel might be helpful in the rules and practices of the I.M.F.?

SIR DENNIS ROBERTSON: Yes. I think to some extent they have been effective, but I think there are probably more to be achieved.

There are some people who think that at this moment there is a terrible shortgage of what they call international liquidity, which is hampering people from doing all sorts of things they want to do and ought to do. I am doubtful of that.

There are two things I have put down here: firstly, the system has to be proof against these attacks by outside speculators. They have made great progress in that in the last year or two. And secondly, there has to be some automatic way of increasing somewhat the basis of the whole system to allow for growth. It is rather a paradox. If it be true that the gold supplies of the world are not increasing fast enough to allow for growth without a deflation of prices, then you have got to supplement this growth

in gold basis by a growth in the created basic money. That means that either the United States or Great Britain have got to be running a slightly adverse balance of payments on all accounts in order to put more international money into circulation, as it were; or, if they can't do that without the risk of the whole thing blowing up, then you have got to have some other scheme for creating international money, not on a big scale, but on a big enough scale to permit reasonable growth. Those are schemes which Bernstein and others have been putting forward -- propositions for allowing the stock of international money to grow automatically, or semi-automatically, so as not to interfere with the expansion of world trade.

I think the International Monetary Fund has two problems to solve. They may be somewhat overlapping, but they are different problems. One is to make the thing proof against the bears, the international speculators; and the other is to allow for annual monetary growth in the basis of world trade. I do not see why it should not be able to recast itself satisfactorily in those two directions. I think it has made a good start, but possibly there is something more to be done.

I think the amount of international co-operation there has been is very encouraging.

COMMISSIONER LEMAN: As a matter of detail, though, was the rule about one per cent plus or minus from the pegged rate something that was picked

old basis by a growth in the crawling peg rate y. That means the either the United States or at least Britain have got to be running a sizably adverse balance of payments on all accounts in order to put more international money into circulation, as it were; or, if they can't do that without the risk of the whole thing blowing up, then you have got to have some other scheme for creating international money, not on a tiny scale, but on a big enough scale to permit reasonable growth. These are schemes which Bernstein and others have been putting forward -- propositions for allowing the stock of international money to grow automatically, or semi-automatically, so as not to interfere with the expansion of world trade.

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I think the growth of international co-operation since the war is very encouraging.

CONGRESSIONAL LIBRARY: As a matter of detail, though, was the rule about one per cent plus or minus from the pegged rate something that was fixed

out of the air when it was set up? Why be quite so severe?

SIR DENNIS ROBERTSON: It is arguable that it ought to be a bit wider. I don't think more people would object to that. But I suppose it was originally an imitation of the old gold point, when you had a really effective gold standard, where nations settled their debts by shifting gold. The cost of packing the gold and sending it across the sea would produce a gap, and I think that frictional gap was rather helpful. It imitates the gap which the gold standard automatically had because of the actual cost of sending gold.

COMMISSIONER MACKINTOSH: I suppose it was in part that the United States, to a limited degree, was still on the gold standard and would ship gold to the other central banks.

SIR DENNIS ROBERTSON: Yes, I think that is right.

COMMISSIONER LEMAN: Have they stopped doing that now?

SIR DENNIS ROBERTSON: No. They are still at a slight premium on the $35 -- I understand a little over or a little less.

COMMISSIONER LEMAN: I did not mean, had the United States stopped shipping gold. What I meant was, have people stopped shipping gold, and do they just ask the guardian to put it to their names and watch over it.

SIR DENNIS ROBERTSON: I saw in the paper

recently that some gold had been moved out of Fort Knox. I suppose it was sent to New York. I suppose that really it is a movement just from the United States government to the Federal Reserve, but I am not informed on that.

COMMMSSIONER LEMAN: The moves or shifts are less than they used to be.

SIR DENNIS ROBERTSON: Yes. It does not move much.

COMMISSIONER GIBSON: I notice in your assessment of the international liquidity problem, you say nothing about the proposition of raising the price of gold. Would you like to comment on that?

SIR DENNIS ROBERTSON: I don't think it is on the map. I think the Americans are determined it shall not be done, and on the whole I believe they are right. If you once do it, then you put everybody on notice that the whole thing has broken down, but the dollar, which is still a great resource in the world, contributing to international liquidity, might completely lose its valuation from that point of view.

Because of what happened once, everybody would think it might very well happen again.

I have got here Mr. Roosa's last announcement made a day or two ago as to what the American stand on it is, which I suppose he has now expounded at Washington. He is digging in again very strongly. He says:

> "Raising the price of gold by devaluing the dollar would certainly be followed by a similar action on the part of other countries. An increase in the gold price would thus not help the United States balance of payments.'

Later he says:

> "But, in fact, devaluation of the dollar would for practical purposes in the future virtually destroy as much reserve liquidity as it might seem to create. For every holder of dollars before devaluation would have been tricked into heavy losses."

And so on. I think they have made out a very strong case for not taking this way out, but for trying to make the thing work on the present basis of the $35 price of gold.

COMMISSIONER LEMAN: Mr. Chairman, that is all I have to ask on this particular subject, unless other Commissioners wish to pursue it.

THE CHAIRMAN: Is there anything further?

COMMISSIONER LEMAN: There is another area

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COMMISSIONER LEMAN: There is another area

that I think we would like to talk about with Sir Dennis. We have talked about the co-operation there should be between monetary policy and fiscal policy, et cetera, and your memorandum indicates at certain spots that these policies have a role to play in their own right.

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER LEMAN: Therefore, would it follow that if the policies have that standing, or the administrators of these policies, they should therefore have about the same degree of separation that goes with the different role each is to play.

SIR DENNIS ROBERTSON: You mean there would be different agencies?

COMMISSIONER LEMAN: First of all they should have different agencies, but what degree of independence from each other should they have?

SIR DENNIS ROBERTSON: It seems to me it is extremely difficult to lay down in terms, when in the end it is all so much a matter of personalities and how the thing actually works in practice from day to day. You can lay down a lot of rules about joint routine, who shall be responsible to whom, and all that.

I thought your central bank governor put it as well as anybody could put it in the statement he made when he was appointed. In the last resort it is the political government which has to take the responsibility, but within that field the freer hand that can be given to the monetary authorities to do their

job, the better.

COMMISSIONER LEMAN: Yesterday Professor Viner -- I don't know if you heard this part of his testimony -- made quite a point of putting in one country's statutes an extremely clear mandate to, let us say, the monetary authority, and perhaps he would so apply this to other agencies of government -- to give them a very clear mandate and, except in emergencies when they would resort to other authority, let them do their job and not interfere too much from day to day or month to month.

SIR DENNIS ROBERTSON: Was that as to Congress, Parliament or the Cabinet?

COMMISSIONER MACKINTOSH: He was a little confused on that, but my recollection is he ended up in our system of government by opting for the Cabinet.

SIR DENNIS ROBERTSON: I think really the Cabinet has got to be responsible for monetary policies, as well as everything else. I think the problem is very different in the United States than in Britain, because of the relationship between Congress and the executive is so different to the relationship between parliament and the government in England. One cannot argue from one to the other. I should have thought that the thing here was more similar to the British system.

COMMISSIONER MACKINTOSH: Oh yes, it is.

SIR DENNIS ROBERTSON: It is really a cabinet government. But the central bank has particular

responsibilities, and it has every right to bring its views to the notice of the government not only in an emergency, but the whole time.

COMMISSIONER MACKINTOSH: Simplifying it, he seemed to be arguing not for the right and duty of the government to issue directives when they felt they were necessary, but that the bank must always operate under at least a general directive which was known to the public.

SIR DENNIS ROBERTSON: Yes, but the bank directive would have to be expressed in such general terms that they would not be much further on.

I have quoted the admirable phrase -- I say it is an admirable phrase, but it does not take one very far: "broad economic objectives of high-level employment, price stability and sustained economic growth". We can agree that everybody has to try to preserve those ends, but in practice one has to be more specific than that.

COMMISSIONER MACKINTOSH: In another context we looked at a copy of the instructions which the Federal Reserve Open Market Committee gave to the Federal Reserve Bank in New York on how to operate in the next week. I must say that my impression was that it contained a lot of generalities.

SIR DENNIS ROBERTSON: I should think it would. I don't suppose they look at it, do they?

COMMISSIONER MACKINTOSH: You are on the record as having said that, not I.

SIR DENNIS ROBERTSON: I will go on the record.

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There is one point which I raised which I am very uncertain about, and I would awfully like to discuss. It is on this relation with the foreign situation.

Looking at the history of the last few years and trying to make what I could of understanding it without really knowing what happened, I bestowed some commendation on the Canadian authorities -- I don't know exactly who they were -- for in 1959 having restricted the money supply -- not added any more to the money supply.

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I notice the money supply had been moving up rapidly until then, but in 1959 although trade was pretty active and the business world was borrowing, it looked as though the authorities had refused to add to the money supply, and as a result the banks had to sell securities to the public in order to be able to make loans to the business world. So you had the banks holding fewer securities but with more loans at the end of the year than at the beginning. That had to my way of thinking the right result, of letting the long-term rate of interest go up in this time of boom.

There are people who say I am completely wrong about that, and that the result of this rise in the rate of interest in 1959 in Canada was to drive the provinces and other people to borrow abroad; and this rise in the rate of interest had the fatal effect of attracting foreign money which you really wanted to keep out.

I read one intelligent discussion of the situation. I think it was by Mr. Neufeld in the English "Banker", who stated the very opposite view to the one I have given. He said you ought to have had a low rate in 1959, where I was commending you for having a high one.

I would like to know what you would think about that. I should like to know whether I was completely wrong about it. I do think that the whole situation is extremely difficult here,

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I would like to know what you would think about that. I should like to know whether I was completely wrong about it. I do think that the whole situation is extremely difficult here,

because it is almost impossible to do right from both points of view. From the point of view of the internal situation, and improving employment and so on, it would seem as if you ought to have cheaper money and more expansion;

but from the point of view of getting your balance of payments in better order it would seem you ought to have a stiff policy, and if you try to have a stiff policy, one aspect of it is higher rates of interest. That clearly has the effect of attracting foreign money, which you don't really want.

That is the awkward dilemma, and I don't see any satisfactory way through it.

COMMISSIONER MACKINTOSH: I think it is clear that our interest rate policy cannot diverge too much from that of the United States.

SIR DENNIS ROBERTSON: True.

COMMISSIONER MACKINTOSH: But I agree that when you have a higher rate of interest, a premium on your currency, and an undesirably high rate of unemployment, you have not a clear situation.

SIR DENNIS ROBERTSON: You have a very sticky one.

COMMISSIONER MACKINTOSH: Perhaps Mr. Gibson could comment on this?

COMMISSIONER GIBSON: I think your comment is very intelligent, Dr. Mackintosh.

COMMISSIONER MACKINTOSH: I did not

doubt that. I thought yours might be fuller.

COMMISSIONER GIBSON: I would like to go back to this question of capital flows with Sir Dennis, and ask him what he thinks a country in the position in which Canada found herself in, let us say, the years 1950 to 1960, should have done in the realm of exchange rate policy. You see, we are subject to capital flows which are quite unusually large in relation to almost any other country in the world. There may be a few small countries that are subject to similar flows, but there is so much inter-ownership in business, so much trade in the short, long and medium-term securities capital is so sensitive to moves across the border, responds to short changes and even long changes. What does a country in our position, subject to these great capital movements in either direction, do in a period of this kind?

One can say we should have a fixed exchange rate. But as we found in the late 40's on two or three occasions it created great difficulties, and it was only after having several problems of this kind that we tried the other, and it didn't work altogether satisfactorily either. However, I would be very much interested in knowing what you feel about that.

Should there be more latitude, for a country in the rather peculiar position we are in, in the international rules?

SIR DENNIS ROBERTSON: I do not know that it makes all that difference. I think the real difficulty is not so much whether the exchange rate is fixed or mobile, but what your national policy ought to be about importing capital. As I say here, it was historically the capital which was the causative thing. Everybody wanted to invest in Canada, and the adverse balance of payments on the current account came about as a consequence of that. It was the way in which you took the foreign loans which people were throwing at your heads.

COMMISSIONER MACKINTOSH: You can argue that the high rate of interest prolonged this flow of capital after it was unsuitable.

SIR DENNIS ROBERTSON: Yes, but what happened is that the adverse balance has gone on and the capital flow has dried up. What do you want to do? Do you want to restore the capital flow or do you hope to do without it in the future? It is a fearfully difficult question.

COMMISSIONER GIBSON: We have only got a couple of flexible items in our picture, and they are the interest rate and the exchange rate. If you fix the exchange rate you put a very much heavier burden on the interest rate as a means of adjustment.

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER GIBSON: What about direct control?

SIR DENNIS ROBERTSON: Although I do not

like direct control I do not know whether it may now be a question of having an interest rate that suits the domestic situation, coupled with the exercise of direct requests and things over the capital flow. It is awfully difficult.

COMMISSIONER GIBSON: It is awfully difficult in this country.

SIR DENNIS ROBERTSON: For the moment you want to encourage capital flow. As a matter of fact, your government borrowed the other day in New York, did it not?

COMMISSIONER MACKINTOSH: Yes. I would think it was desired to restore a more moderate capital flow which one might hope, generally, would decline over the years.

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER MACKINTOSH: Whatever the aim of the action taken was the result was too blunt and abrupt.

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER LEMAN: This leads into another general type of problem, Sir Dennis, about the central bank. Again it arises out of some remarks of Professor Viner, and also out of a lot of other discussions that have taken place over the years as to what should the central bank do. Should it indulge in long-range forecasts of what is going to happen, or should it keep looking at what is happening this month or next month. Your worry: "Was I right about 1959?" may have something to do

with this. Should the monetary authority ask itself: "Now, should I with this restrictive policy be curing the policy I had before, but I see evidence here that proves to me that in 1960 we will have a turn-around and I will have caused trouble for myself".

SIR DENNIS ROBERTSON: Yes.

COMMISSIONER LEMAN: Do you see the central banker operating in that way with fairly long-range forecasting, or should there be something left to other agencies of government?

SIR DENNIS ROBERTSON: No, I think all the agencies of government ought to be working together. They each have their research staffs and I think they ought to be in pretty close touch and communication. I think the central bank may on some occasions have to go to the immediate problem in spite of the fact that in the long run something else is going to happen. I do not think it ought to go into it blindly. I think sometimes it does have to look after itself a bit.

COMMISSIONER LEMAN: I gather from your earlier remarks that you do not like very much the process that used to be called just leaning against the wind all the time. You favour a good arsenal of weapons in the hands of the monetary authority to be used according to its judgment with more or less determination and wiles according to the circumstances, and, therefore, if we are going

to give it so much of an arsenal we have got to ask ourselves: "Well, how far in the future is it going to look?"

SIR DENNIS ROBERTSON: Well, I think you may have to say: "Well, as I do not know what is going to happen about the future I will therefore do the best I can with the present". That expression "leaning into the wind" reminds me of an expression Lord Cobbold used which was to the effect that it was no good spitting into the wind. The question is as to when leaning into the wind becomes spitting into the wind. Leaning into the wind is a good thing to do, but spitting into the wind is a bad thing to do.

COMMISSIONER GIBSON: I would like to ask one more question, Sir Dennis. What is your view about the kind of international economic climate we are looking forward to in the next decade. Is this a time of shortage of capital? Are there inflationary forces still at work? How do you look at the period ahead?

SIR DENNIS ROBERTSON: I think this is an extraordinarily puzzling moment. In the last few weeks we are, perhaps for the first time in many years, looking ahead into a more deflationary period. Per Jacobsson, whose name has been mentioned frequently, has been talking in this same way, and it is rather remarkable that he should be talking of deflation. It is this question of raw materials all over the world. It is too much

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like 1929 to be very satisfactory.

On the other hand, there is obviously this extraordinary pressure of capital development all over the world. I do not think inflation is cured completely, by any means, because of this cost-push thing that is not under control anywhere. I think it is a fearfully difficult moment. In the last few months, for the first time, as I say, I have thought that there was some risk of a general world deflation like that of the late 1920's. So, it tends to be harder than ever to do the right thing, I think.

COMMISSIONER GIBSON: In any event, you do not feel there is any reasonably clear trend ahead of us? It is pretty doubtful as to ---

SIR DENNIS ROBERTSON: I think it is awfully doubtful.

COMMISSIONER GIBSON: This ought to make in some ways the job of the central bank a little easier?

SIR DENNIS ROBERTSON: Well, do you think so?

COMMISSIONER GIBSON: Is it harder to fight against inflation or is it harder to try and assess a position that looks more neutral?

SIR DENNIS ROBERTSON: You see, it is not neutral. That is the trouble. So many countries seem to be suffering from inflation and

unemployment, which is the worst possible combination.

COMMISSIONER MACKINTOSH: Do you not think that is a time when you could accept more risk with policies which might have inflationary effects than you could five years ago?

SIR DENNIS ROBERTSON: I think that is so. I think it is certainly so in the United States. It may be so with us. I got so tired of the people who have been telling us: "Go ahead; go ahead and don't wait. Let's get away from the dead hand of the treasury which is against any efforts towards promoting growth", and so on, that I am very loath to admit that they may be in the end proved right.

THE CHAIRMAN: Sir Dennis, we appreciate the very provocative discussion we have engaged in with you, and we thank you for the very great help you have given us. I am sure that my fellow commissioners will agree with me when I say that the contribution you have made will be very valuable to us in our deliberations.

SIR DENNIS ROBERTSON: That is very kind of you, Mr. Chairman. I am afraid I have not been very helpful because I am so extremely doubtful about everything.

THE CHAIRMAN: Well, I think that is one thing about which we disagree.

SIR DENNIS ROBERTSON: I have very much enjoyed meeting with the Commission.

THE CHAIRMAN: We shall now adjourn

until 9.15 tomorrow morning when we shall hear the submission of the Canadian Federation of Agriculture.

--- Adjournment.

Royal Commission
on
Banking and Finance

SIR DENNIS ROBERTSON

Hearings
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Memorandum for The Royal Commission
on Banking and Finance, Canada.

1. Introductory.
2. Population Policy.
3. Regional Policy.
4. Growth Policy
5. Prices Policy.
6. Taxation Policy.
7. The Money Stock.
8. The Money Flow - The Banks.
9. The Money Flow - The Public - Deflation.
10. The Money Flow - The Public - Inflation.
11. Cost Inflation.
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16. Coordination and Communication.

Prepared by Sir Dennis Robertson,
July 28, 1962.

1. Introductory

In the admirable statement issued on the morrow of his appointment, the Governor of the Bank of Canada alluded to the "broad economic objectives of high-level employment, price stability and sustained economic growth." As a means to the attainment of these ends, he emphasized the need for the coordination of financial policy with general economic policy, the former in turn consisting of the three "inter-dependent and to some extent interchangeable" strands of monetary policy, fiscal policy and debt-management policy. I shall try to arrange my remarks in the light of these two dissections, the one of ends, the other of means; bearing in mind as regards the second that, as I understand it, the Commission's primary concern is with the genus "financial," and within that genus with the species "monetary."

Fashions change. Fifty years ago, all the lime-light might have been concentrated on stable prices, thirty years ago on high employment. But nowadays no public personage can afford to let slip an opportunity of reminding us of what in my young days was taken for granted, namely that modern communities normally both are and desire to be experiencing growth, in the simple sence of an increase over any span of years -- not necessarily in any single year -- in the total of measurable real output or income. So Mr. Rasminsky was quite right to include growth; and I am sure no-one realizes better than he both that the available methods of

measuring it are imperfect, and that growth itself is at best a means rather than an end, and moreover is apt to be accompanied, as it has been in Britain, by damage of various kinds, some of which is inevitable, and some, while not inevitable, is not very likely to be avoided.

2. Population Policy

The Commission will not wish to spread its net unduly wide; but I fancy it may find itself impelled to indicate whether it is more concerned to promote increase of aggregate real income or of real income per head; and further whether it therefore regards a "population policy" as one of the things with which financial policy must be harmonized. It seems to me that special strains on those in charge of financial policy are likely to arise in countries (such as Australia) which are anxious for non-economic reasons to encourage a smart rate of growth of population, or in countries (such as India) where population is in fact increasing faster than the framers of general policy would wish. I should imagine that taking a long view Canada, with her friendly neighbours and her abundant natural resources, should be relatively free from such preoccupations, and able more or less to let population matters, both in respect of natural increase and of immigration, take their course.

Nevertheless the difficulty which has been found in the last few years in attaining the objective of high employment -- or more strictly of low

unemployment -- draws attention to a special trouble which may befall a country whose free institutions and rich resources have made her for decades a magnet to the robust and enterprising -- namely that a short period of needed digestion and re-appraisal after a specially rapid upthrust may face her with a temporary problem of superfluity of manpower from which a less dynamic economy would be exempt, and with which purely financial policies may prove inadequate to cope. One can only hope that such reculements pour mieux sauter will prove of short duration.

3. Regional Policy

More likely to be persistent is a problem from which Canada, with her large physical span and wide variety of natural conditions, cannot hope to be immune, namely the attitude to be adopted in the face of widely varying regional propensities to growth or decay. Ought special efforts to be made to bring work to the workers in the less fortunate areas? Or will such efforts only serve to obstruct the more growth-promoting solution of intra-national migration of labour towards the points of higher return? Is there conflict here between two of the "Rasminsky objectives?"

I cannot illustrate the problem better than by quotation from the paragraphs in which, in a most interesting recent (1961) Report, (Economic Development in the Atlantic Provinces, p.19) Professor A.K. Cairncross seeks to justify his proposal for doubling or trebling over a span of years the numbers engaged in

certain specially selected industries in the Atlantic Provinces. The argument he urges, is twofold:

> "the probability of a labour surplus after allowing for migration to other parts of Canada; and the probability that, for a limited range of industries, costs of production would not rise perceptibly (except perhaps in the first year or two) if a location in the Atlantic Provinces were selected in preference to a location in central Canada......... I fully accept the need to push ahead with the development of those areas of Canada that have the greatest growth potential, and I see long term advantages in encouraging the movement of labour from declining to expanding areas. But I recognize that there are limits to the scale on which labour transfers are possible <u>without inflicting lasting damage on the economic and social life of both types of area</u> (DHR's italics); and there appears to me a serious danger that, at current rates of population growth, these limits would have to be exceeded if no special efforts were made to develop new industries in the Atlantic Provinces."

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In this instance, the argument thus runs, a laissez-faire policy would not, as at first sight might appear, be superior to an interventionist one from the point of view of the effect on the overall rate of growth, partly because those workers who migrated would not in fact become much more productive elsewhere, and partly because migration would not in fact be on a large enough scale to drain off and re-employ all the redundant labour. I have neither the knowledge nor the desire to impugn Cairncross's conclusion; though the words which I have italicized suggest to me that in reaching it he has attached more weight than he makes quite explicit to a third concept more elusive than either productivity or employment, namely the welfare of "the region" as such, distinct from the welfare of the individuals who dwell, or who no longer dwell, therein.

4. Growth Policy

Let us return to the concept of the rate of increase of output, and be content for the moment to deal with it as a national average, computed over all regions and all occupations. Given the rate of increase of the working population and the length in hours of the working year, this rate of increase of output may be regarded as depending, over a run of years, on two things, -- the rate at which the country's stock of capital instruments of one kind and another is growing, and the rate at which improvements are being effected in technology and organization. These two elements of growth are not independent of one

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another, and at the present time much high-powered intellectual effort is being devoted by economic "model-builders" to analysing their inter-relations. I doubt if the Commission will desire to give the time to go deeply into these sophisticated argumentations; and if it does I am not the man to expound them! I venture to think that, up to a point at least, useful results can be reached by treating these two factors in growth, which I will call for brevity capital formation and technical progress, separately; since the role of policy with regard to them is inevitably somewhat different. Governments can take steps of various kinds to encourage both; but not even a totalitarian government is able to determine, or even to predict for any length of time ahead, the rate of technical progress. On the other hand such a Government is in a position to determine pretty closely the proportion of a country's productive power which shall be devoted annually to increasing its capital equipment; and, even in a country in which the ultimate powers of decision in this matter are still mainly decentralized in the hands of private individuals or corporations, the government may itself be charged with making the relevant decisions over such a sizable part of the field, and be so confident of its powers of persuasion or prediction over the remainder, that the overall rate of capital formation has come to be regarded as virtually a matter of national policy.

The Commission may or may not be so well satisfied that there are good reasons for desiring Canada

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The Commission may or may not be as well satisfied that there are good reasons for doing this

to grow at one rate rather than another, and so confident that what is desirable in this matter is also attainable, that they are ready to follow some notable precedents in tossing a growth-rate figure into the arena of discussion. I must confess that my own sympathies were on the side of the recent United States Commission on Money and Credit in their refusal, in spite of pressure from some of their members, to take such a course. (Report (1961), p.31). But whether or no, there are questions about the implications of growth for the various branches of financial policy which do seem to be clearly within the Commission's responsibilty to face.

5. Prices Policy

Boring and academic as it may seem, I think it is helpful to start by considering how a Monetary Authority should behave in a country which was isolated from the rest of the world, and in which it was desired so far as possible to leave the pace of capital formation to be determined by the unfettered interplay of the decisions of private enterprisers and savers.

In general terms the answer seems to be that in such conditions it should be the aim of the Monetary Authority to generate such a flow of monetary demand for final output as to enable the participants in the growth process -- enterprisers, savers and hired workers -- to realize their intentions with a minimum of friction and of distortion of the true significance of the monetary contracts which they are making with one another. Attainment of this aim could

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be described as the preservation of "monetary equilibrium;" and, assuming the Authority to be working with and through a modern system of deposit banking, we can put the same thought in different words by saying that its aim should be to ensure that the creation of money by the banks is being carried on in just such a way and on just such a scale as to ensure that the banking system really is what bankers believe it to be, -- an efficient instrument for putting the genuine savings of the public at the disposal of trade and industry.

When however we try to express this aim more precisely in terms of income and prices, we encounter difficulties. The first interpretation which suggests itself is that what from now on I will call for brevity the "money flow" should be caused to expand in proportion to any increase that may be occurring in the working force, i.e. that the aim should be (broadly) to preserve the stability not of prices but of money income per head. But that interpretation will be seen to be too restrictive when we reflect that another factor of production, namely capital equipment, is also growing, and that its owners will also be claiming their annual reward. So we are led on to think that the money flow should be expanded sufficiently to allow for this, though not sufficiently to balance that part of the increase in output which is due not to the growth of capital equipment but to technical progress. Thus the general level of prices of final output would be allowed progressively to fall, though by no

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means in full proportion to the increase of output.

When however we reflect further that what is going on may well be altering the relative scarcities of the two factors of production, Working and the Provision of Capital, we may well be hard put to it to see just how large an expansion of the money flow would be needed in order thus to preserve stability not of final prices but of what may be called the "average price of productive power" . And remembering at this stage the difficulties which Monetary Authorities have in achieving what they want to achieve -- remembering also the various pressures which they will be under to implement or acquiesce in a continuous *rise* in final prices -- we may well be tempted to throw perfectionism to the winds, and to accept for practical purposes what to many people seems, though in fact it is not, the most "natural" objective of all, namely stability of the final price-level.

To this temptation I, in connon with some whose judgment I most respect (I may mention Professors Haberler and Robbins), have succumbed -- though always with a twinge of conscience when I see the more scientific view movingly expressed by some discerning non-economist. (E.G. by the Bishop of Monmouth in a letter to the *Times* of Jan. 11, 1962, which concludes: "To a simple fellow like myself it seems that the lower prices which increased productivity makes possible would benefit everybody, but I recognize that there must be a flaw in my thinking, for increased productivity has not brought -- and does not seem likely to bring --

lower prices. Presumably there is good reason for this. Will someone explain?" Nobody did). This makes it the more incumbent on me to insist on three things. First, if questions arise of a possible conflict, and therefore a necessary compromise, between the "Rasminsky objectives", it should be remembered that the price-stability objective is itself already a compromise. Secondly, the practical case for stability refers only to the average of prices and in no whit impairs the case for requiring that in lines of production where technical progress is specially pronounced prices should continuously fall. Thirdly, and in appearance somewhat paradoxically, an understanding of the true reasons for ensuing "stability" may prevent us from launching undeserved criticism at a Monetary Authority if in the face of a reverse movement of productivity, occasioned by bad harvests or other natural misfortunes, it permits a rise in the price level. For such action may be in the true sense stabilizing, provided of course it is not allowed to touch off a "compensatory" rise in money incomes.

6. Taxation Policy

But we are getting to grips a little too quickly with the real world! Let us return to our imaginary country (beginning of § 5), and for such a country take, with some reservations, stability of prices as a sufficiently good indication that monetary equilibrium is being successfully maintained. The next thing to observe is that in principle such a

happy state of affairs may exist also in a country in which the Government is taking a hand in the growth process. On examining such a country, we might find that the Government was running a surplus of current receipts over current expenditure and using the surplus to repay old debts, thus appearing only on the supply side of the capital market; or we might find that it was using such a surplus to finance the creation of capital equipment, thus appearing in equal strength on both sides of the capital market, i.e. (by and large) not appearing at all. Or again we might find that it was chronically appearing on the demand side of the market, either partly to finance a current deficit, or exclusively to finance the creation of capital equipment. The Finance Minister may be framing his policies in these respects in the light of a combination of principles and rules of thumb which do not perhaps commend themselves to his political opponents but are, as things go, intellectually quite respectable; and he may be so fortunate as to find that the Monetary Authority can take his decisions as data and yet do its particular job of preserving monetary equilibrium with success.

For instance, as Finance Minister in a country in which a number of branches of productive industry have passed into public ownership, I can easily see myself deciding that that fact affords no good ground for supposing that all their expenditures on capital development should be met out of taxation, and imposes on me therefore no obligation to achieve

an "overall" budget balance. But I can also see myself deciding, with perhaps vulnerable logic but saving common sense, that I must turn a very critical eye on any suggestion that, because some piece of expenditure in the field of education or health is not only desirable in itself but should increase "productivity" in the future, it is therefore a proper subject for finance by loan rather than by tax.

Before giving limited endorsement, as I shall presently do, to the claims of Central Bankers and other than Fiscal Policy must be prepared to come to the aid of Monetary Policy in ensuing "monetary equilibrium", it is well, I think, thus to stake out a claim for Public Finance as a serious subject in its own right, with a philosophy and experience of its own, and incapable of being pushed around, in the interests of stability, beyond a certain point without damaging consequences.

7. The Money Stock

Still maintaining for a while longer the pleasant fiction of an isolated economy, let us put ourselves in the position of a Monetary Authority which, in the shape of a Central Bank, is endeavouring to pursue whole-heartedly the objective of monetary equilibrium. What weapons does it need, and what obstacles will it encounter?

As a minimum requirement it would seem that it must be in a position to exercise control, both in an upward and downward direction, over the quantity of money in the hands of the public. (I use the word

an "overall" budget balance. But [illegible]

could not, with perhaps [illegible] logic but [illegible] common sense, [illegible] any [illegible] but, [illegible] degree of [illegible] in the field of [illegible] possible [illegible] in the future, it is [illegible]

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"money" in the sense now commin in Britain, and apparently also reasonably appropriate to Canadian conditions, of notes and coin plus <u>all</u> the deposit liabilities of the cheque-paying banks). For the Bank to be in this position there must be a quantitative link, established by law or reliable custom, between the deposit liabilities of the banks and their reserve balances held with itself; and there must be an active market through which, by dealing in securities with the banks or their customers, it can operate on the magnitude of these reserve balances. These things the Bank of Canada has; and I gather that it is free from those inhibitions against dealing in long as well as in short term securities which in recent years have to some extent cramped the style of its United States counterpart.

But there seems to be need also for a third thing. In a free economy it is not easy to see a central banking system functioning acceptably without the existence, in the hands of somebody or other, of a right of access to the Central Bank as a "lender of last resort", and there seems to be need therefore for some element of friction or stiffening to prevent such rights from being exercised on such a scale as to stultify the power of the Central Bank to prevent the total of bankers' balances from rising above the level which it desires to establish. In England the requisite "sting in the tail" used to be, and after a long period in abeyance is now again, embodied in the system by the Central Bank's right to charge a

"money" in the sense now common in Britain, are apparently also not really appropriate to Canadian conditions, of notes and coin plus all the current liabilities of the cheque-paying banks. For the Bank to be in this position there must be a quantitative link, established by law or reliable custom, between the deposit liabilities of the banks and their reserve balances held with itself; and there must be an active market through which, by dealing in securities with the banks or their customers, it can operate on the magnitude of these reserve balances. These conditions the Bank of Canada has; and I gather that it is [illegible] from those inhibitions against dealing in long- as well as in short-term securities which in recent years have to some extent changed the style of its operations.

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penal rate of its own choosing to those to whom it agrees to act as lender of last resort. So to English eyes the practice prevailing in Canada between November 1956 and June 1962, by which Bank rate was fixed mechanically week by week at a bare fraction above the previous week's average rate for Treasury Bills, had an odd air, and smelt somewhat of abdication from an important function.

This matter of Bank rate has other facets, to which I shall return; for the moment I want to stick closely to the question of the quantity of money. In England the experience of the post-war years has made it plain that even the exercise of the "sting in the tail" against the immediate wielder of the right to borrow is of very little use in guarding the Central Bank's control over the money supply if the <u>ultimate</u> borrower is one who also claims an implicit right not to be sent empty away and who is virtually impervious to any practicable increase in the cost of borrowing, i.e. is the Sovereign Government itself. It seems to me clear that the British Authority's loss of control over the money supply in the years culminating in 1957 was closely bound up with its unwillingness to see the establishment of appropriately high rates of interest in the longer term capital market, and with the consequent need to put the banks in a position to supply by the purchase of Treasury Bills the heavy recurrent needs of Government for funds wherewith to implement the re-financing of war debt and the

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capital requirements of publicly owned industry. The Radcliffe Committee on the Working of the Monetary System deserves much credit for turning the limelight (1959) on this whole story, though they were themselves more interested in other aspects of it than in its bearing on the money supply; and my own impression is that the rectification of this situation since 1957, through the reduction of the Government's overall deficit and through the establishment of a higher level of long term interest rates, has been the most important and effective of the steps that have been taken in Britain to bring the long post-war inflation to a halt.

It is naturally in the light of this impression that I have studied the Canadian figures showing that in the four years 1958-1961 the deficits of the public sector (all branches, on the national income accounts basis) totalled some 3 billion dollars, while the money supply increased by some 3 billion dollars or over 25 per cent. One does not need, I think, to be a dyed-in-the-wool budget-balancer to regard these figures with some anxiety. In any case I find myself impelled to regard with retrospective admiration the crucial decision apparently taken at the end of 1958, when public sector deficits of a billion dollars had already been reflected in the increment of a billion and a half in the money supply, to cause the re-expanding private demands for loans to be

capital requirements of publicly owned industry. The Radcliffe [illegible] on the [illegible] of the [illegible] rather deserves much credit for turning the tide [illegible] (1959) on this whole story, though they were themselves more interested in other aspects of it than in its bearing on the money supply, and my own impression is that the main direction of [illegible] since 1959, through [illegible] determination of [illegible] deficit [illegible] establishment of a higher level of [illegible] interest rates, has been the most [illegible] and effective of the steps that have been taken to [illegible]

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met not out of a further dose of newly created money but out of the proceeds of bank sales of securities to the public, entailing a substantial rise in the long term rate of interest.

8. The Money Flow - The Banks

Control of the money supply is not an end in itself, nor a means to an end, but only a means to a means to an end. The end - itself one of several possibly conflicting "Rasminsky objectives" - is monetary stability, the means to the end is control of the rate of flow of monetary demand for final goods and services. There are a number of parties who, by taking initiatives of various kinds, can so alter the average speed at which the stock of money circulates as to aggravate, or alternatively to counteract, the influence exerted on the rate of money flow by the actions taken by the Authority with respect to the size of the money stock.

The first party to be mentioned in this connection is the banks themselves, which can alter the effectiveness of a given stock of money by changing the composition of their assets. I have just given an illustration from recent Canadian history of large scale action of this kind which was presumably in accord with the intentions of Authority, who in keeping the money supply constant during 1959 presumably desired not that the expansion of trade activity should be stopped dead but that it should be kept under control. But it

is easy to imagine circumstances in which such a shift would be unwelcome, and the question therefore arises whether the Authority should not be given some powers over the composition as well as over the total size of the banks' non-cash assets. A half-way house is to give it the power of prescribing the minimum proportion of these that must be of a specially liquid character, as is done (by agreement though not by law) in both Britain and Canada. A further step, taken in Britain with some reluctance in 1961, is for the Central Bank to have the right of requiring a variable quantity of "special deposits" to be made with itself by the banks, these not counting as cash reserves or even as "liquid assets". It is not a very long step from this to prescribing a maximum level or proportion of advances. In Britain this final step has not been taken; on the other hand use is still being made of the power given by post-war legislation to indicate by directive the priority or posteriority to be accorded by the banks to various broadly defined categories of borrowers. I should regret this more than I do if I did not feel that the banks had served the community rather badly in 1959 by the alacrity with which they used their temporarily restored freedom in "going gay" over hire purchase and other ingenious devices for persuading the consumer to overspend his means. But I think there are dangers about the present degree of regimentation, especially if anything should come

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of the vogue now enjoyed by ideas about co-operative industrial planning on the French model, which appears to depend for its efficacy partly on the application of centrally inspired financial sanctions against individual firms found to be backward in co-operation with the plan.

Monetary control through a multiple banking system has never been, as has sometimes been claimed, a completely undiscriminating or impersonal process. What it has done, even where, as in Britain and Canada, the banks are few and powerful, is to preserve a healthy degree of decentralization of judgment in the allotment of funds. Can the Commission find a formula which will help to perpetuate this advantage without hindering the Central Authority in its duty of safeguarding the value of the monetary unit?

It remains to notice that, as a whole batch of popular metaphors about taking horses to the water and pushing on shoe-strings bears witness, control of the money supply is generally recognized as being inadequate to prevent the money flow from falling below some assigned level. In § 7 I neglected, as of no importance in Britain or Canada, the possibility that the banks will keep "excess reserves"; but we cannot neglect the possibility that under some conditions they will utilize a surplus of reserves in buying securities from some holders who will keep the proceeds of sale entirely idle, thus for the

moment contributing not one whit to the expansion of the money flow as we have defined it. (I had better perhaps explain that I do not agree with my ex-colleague Prof. R.F. Kahan in regarding this obvious fact as a valid reason for holding that "the velocity of circulation, as normally conceived, is an entirely bogus concept" -- Radcliffe Committee Memoranda, Vol. III, p. 144, para. 61). This indeed is the main reason for which public opinion has been won over the necessity for associating fiscal policy with monetary policy in the quest for monetary stability. It is however important to remember that under other conditions the purchase of a security may succeed in bringing money into touch with goods and services as effectively and almost as speedily as the making of a loan.

9. The Money Flow - The Public-Deflation

We have now reached the central problem, -- the extent of the power of the users of bank money to thwart the intentions of Authority by altering the speed with which the money circulates. It is generally agreed that there is a certain asymmetry between the two halves of this problem; and in continuation of the line of thought opened up at the end of the last section we may start with the limitations on the power of the banking system to stimulate expansion or arrest contraction in the flow of money demand. I do not myself doubt that if the general business atmosphere is reasonably

good or even neutral, an opening out of credit facilities, or any easing of the terms on which they are supplied, can play a useful part in stimulating marginal capital expenditure and maintaining activity. So can the various possible methods of encouraging the production of dwelling houses. Moreover now that in general estimation various other "durable consumption goods" have joined dwelling houses as objects for the acquisition of which it is proper to run into debt, a new potential weapon has been added to Authority's armoury; and though experience has shown that it is a somewhat dangerous weapon, difficult to wield deftly and a good deal disliked by the industries which it affects, I do not think a modern Authority can afford to decline to learn to handle it.

But in the face of a general sharp decline, for good or bad reasons, in business confidence, such peripheral activities cannot do a great deal to outweigh an obstinate reluctance on the part of the large holders of money balances to use them,or entrust their use to others, for any purpose whatsoever; and it becomes legitimate, as I have already said, for Monetary Policy to call her sister Fiscal Policy to her aid. Nor do I think we can rely solely on the considerable degree of compensatory movement which is "built in" to many modern fiscal systems owing to the operation of unemployment relief on one side of the account and progressive scales of income tax

on the other: there may well be need for futher action on a discretionary basis.

As to the form which such action should take, here is another matter (compare § 1) in which fasions are apt to change. In the old days the cry of reformers was for capital works of a manifestly useful character, organized and paid for by the State; (I find myself writing in support of such ideas in a book published in 1915; and a little later (1926), impressed by the difficulties of organization and timing which others had pointed out, alluding to the "once....heretical but now perhaps over-respectable policy of 'public works'".) in those days the idea of promoting recovery by simply giving money away through the Budget would still have been thought rather shocking. Nowadays however we find Dr. Roosa of the United States Treasury assuring Congress (The <u>Times</u> (London), June 21, 1962) that foreign bankers would not be shocked at the sight of an American deficit caused by a reduction in tax rates, but might be if the deficit were caused by an expansion in Federal spending; and I suppose he may very well be right. On purely rational grounds I think (and for all I know Dr. Roosa) would opt for the public works -- of course carefully selected and organized; since I am not sure that in the supposed circumstances we could rely on taxes unconditionally remitted to wealthy persons or corporations being swiftly or effectively spent, and since I am Galbraithian

enough to suspect that the United States is still a bit short of social capital. (Perhaps I am out of day; but I hope that she will not go through another major depression without doubling the number (viz. one) of public lavatories which in 1943 I was able to discover in her capital city).

As for the third sister, Debt Management, I expect that in the conditions of pronounced depression now under analysis, she would be wise to keep rather in the background. Her long term job, and it is a very important one, is to keep up a steady pressure against the shortening of the average life of the outstanding debt which occurs through the passage of time, and to keep the country up to paying such longer term rates of interest as are necessary for that purpose. But there are times and seasons for all things; and without pretending to know the full facts I have a feeling that in Canada in 1958 she pressed her side of the story with an insistence not altogether appropriate to the conjuncture.

10. <u>The Money Flow - The Public - Inflation</u>

Let us turn to the other side of the picture. If it were not for the pressures from the side of Public Finance alluded to in § 7, would there be any doubt about the power of a banking system, whose several parts are kept working in harmony through the network of rules and understandings described in § 7 and § 8, to prevent the level of money demand from <u>rising</u> to undesired heights?

It used to be thought not; it used to be thought that, through a combination of rate manipulations and informal rationing procedures, such a Monetary Organ should always be in a position to exercise on business borrowers a deterrent effect sufficient to check and if necessary reverse an upward thrust of money demand.

I will first set out very briefly the general arguments which are nowadays brought against this optimistic conclusion, and then, at a little more length, a particular one which has been specially prominent in the recent literature. The general argument may be summarized under two heads as follows. First, so far as rates of interest are concerned, whether we are thinking of short rates and investment in inventories or of long rates and investment in machines, the practicable rises are too small, as compared with the anticipated rates of profit on which entrepreneurial action is based, to have any appreciable deterrent effect. Secondly, as regards availability of funds, many of the largest and most important enterprises are not in the habit of borrowing from their banks. Either they have large liquid funds of their own; or they can in effect avail themselves of other people's by forcibly taking "trade credit" from their weaker customers or suppliers; or again they will find that the upward movement of interest rates, while insufficient to affect their own desire to

borrow, is proving sufficient to induce a number of owners of idle balances to lend them in the market. (*Per contra*, it is argued (sometimes by the same people) that the passive holders of fixed interest *securities* (as opposed to *balances*) will be impelled by the rise in interest rates (fall in price of securities) to hang on to these securities when they would otherwise have sold them and lent the proceeds to the active intrepreneurs. Presumably this effect is regarded as going some way to cancel the effect mentioned in the text). Thus one way and another the velocity of circulation of existing money is increased (according to the extreme exponents of these views it may even become infinite!), and the stream of money demand continues to swell.

The particular argument is really a special case of the second branch of this general argument. It calls attention to the prominent part played nowadays in the capital markets by institutions which are not banks, and which are free therefore from the quantitative restraints imposed on the lending operations of the banks. They will thus be in a position to invite the owners of bank money to commit it to their charge, and will lend it out again to the purchasers of goods and services who are finding difficulty in securing loans directly from the banks. This churned -up bank money will exert just as strong a price-raising influence as would have been exerted by the additional bank money which *ex hypothesi* the banks are being prevented from creating.

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And this inflammatory process is none the less real, and none the less unfair to the banks, because the latter, fixing their gaze on the earliest phase of the process, are apt to mis-describe it as one in which they are "losing deposits", instead of as one in which they are losing profitable business, to the outside institutions.

On the question of fairness, I myself feel that there is still a sufficiently clear difference between what is "money", i.e. an undisputed (even if not legally enforceable) means of final discharge of a debt, and what is not, to justify some degree of difference between the constraints placed upon banks -- who have virtually become participants in the royal prerogative of creating money -- and other institutions. As regards the public interest, appropriate action depends no doubt on the magnitude of the problem. The Radcliffe Committee, having in mind mainly the hire-purchase finance companies, regarded it as very important. In the United States, the hire-purchase companies, are forbidden to accept deposits; and the American Commission, having in mind chiefly the general run of savings institutions, dismissed the whole problem as of no importance, pointing out that transfer of demand deposits into these institutions "is more likely to increase velocity in recessions than in booms and thus to assist rather than offset the effect of

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On the question of attitudes, I myself feel that there is still a sufficiently clear difference between what is 'money', i.e., an undisputed (even if not legally enforceable) means of final discharge of a debt, and what is not, to justify some degree of difference between the restraints placed upon banks -- who have virtually become part of, and in the formal prerogative of creating money -- and other institutions. As regards the public interest, appropriate action depends no doubt on the magnitude of the problem. The Radcliffe Committee, having in mind mainly the hire-purchase finance companies, regarded it as very important. In the United States, the hire-purchase companies, are [illegible] [illegible]; and the American [illegible], having in mind chiefly the general run of savings institutions, dismissed the whole problem as of no importance, pointing out that transfer of demand deposits into these institutions is more likely to increase velocity in recessions than in booms and thus to assist rather than offset the effect of

monetary policy". (Report, p. 79). I am not in a position to offer any opinion on the importance of the problem in Canada, and will only venture to suggest that the British compromise, whereby certain "requests" made by the Bank of England to the clearing banks are now also made to a considerable number of other institutions, but no attempt is made to impose quantitative regulations on the latter, may be worthy of consideration.

On all these matters there is now a huge corpus of evidence to which the Commission will presumably be procuring additions, and only a little of which I can claim to have worked through. I shall no doubt be accused of wishful thinking if I say that, after Britain's experiences in 1957-62, I am still persuaded that "credit squeezes" can be made to bite over a sufficient range to be very effective, though they may take rather longer to operate and may require to be furnished with more varied teeth than used to be supposed, and though they may have differential effects which are not wholly welcome. Rather than attempting to defend this position at length, I will ask brief attention to two considerations arising out of it.

The first takes us back to Bank rate (see § 7). In Britain Bank rate is not only part of the machinery by which the Central Bank guides the other banks but also, owing to the rigid conventional links between it and the rates for bank

advances, part of the machinery by which the banking system as a whole influences the behaviour of the public. I am not sure that the extreme rigidity of these links is a good thing in this country, still less that it is to be recommended for imitation in others. But some connection between the various short rates of interest there must be; and it is important that the extent to which the Central Bank is responsible for all of them should not be played down or camouflaged.

I do not think the duty of the Central Bank in respect of interest rates, short or even long, can be properly expressed by saying that as far as possible it must leave them to be determined in a free market, -- it is itself inevitably too much a part of the market for that to make sense; it is its duty to influence the rates, but in a direction and a degree consistent with the long term forces operating in the economy. I venture to think it would help to make this plain if Canada, having partially (For, if I understand aright, the new method only applies so far to the quantitatively less important part of these support operations, viz. the advances to the banks, and not to the "purchase and re-sale agreements" with dealers) returned in June 1962 to the principle of a Bank rate fixed at the complete discretion of the Central Bank, were to complete the return to that principle, and not again to depart from it. Incidentally, I would suppose the

limitation of the chartered banks' prime lending rate to 6 per cent to be an anachronism which should be abolished.

The second consideration takes us back to Fiscal Policy. We have seen (§ 7) that she must not actively sabotage her sister's efforts to control an inflationary situation. And both the Radcliffe Committee (para 560) and a certain British White Paper (Cmnd. 1203 of 1960, pp. 6-7) seem to me to go too far towards suggesting that public capital expenditure should never be expected to make a serious contribution towards the scaling down of inflated demand; of course the directors of publicly owned enterprises do not like having to draw in their horns, but neither does anybody else. Provided however she makes some contribution on this expenditure front, can Fiscal Policy be allowed to stand aside on the ground that her sister can get on better without her help in an inflationary than in a delationary situation? I think that would be wrong. As Professor J.M. Buchanan of Virginia has been pointing out, (Lloyds Bank Review, April, 1962, pp. 17-30) while it is nice to be lent money, it is nicer still to be given it; and while it is nasty to be refused a loan, it is nastier still to have one's pocket picked. So since Governments like giving people what they like, they will have a certain built in bias towards making expansions of the monetary stream predominantly by fiscal means and contractions

predominantly by banking means; this would not be for the health of the economy, and must be resisted.

My reminder therefore of the independent status of Public Finance (§6) must not be read as a plea for her exemption from unpleasant anti-inflationary duty, but rather as a plea that in all phases of the conjuncture she has other things to think about than the pace of the economy, and should not be expected to display a degree of flexibility which is foriegn to her nature. (If I may quote from a paper of my own, read on the Continent of Europe thirteen years ago, "The curious habit of paying taxes is a very valuable, and a somewhat sensitive, plant. In my country at least, it has shown itself capable of standing up to very heavy burdens, imposed and administered with consistency and fairness. It remains to be seen how it would stand up against the frequent, swift and apparently capricious changes which might be needed to make fiscal policy function successfully as the sole regulator of economic activity."

11. Cost Inflation

Are we ready at last to throw open the frontiers to international influences and see what happens to the structure we have painfully built up? Not quite, even now. There is one more outside lion who has been described lying in the path of domestic monetary management, and whom we cannot

avoid facing. This is the alleged tendency, under modern systems of collective bargaining supplemented by arbitration, towards a chronic spontaneous upthrust in the level of money wages, carrying with it a consequential rise in the level of prices and in the flow of money demand, which the Monetary Authority could only reverse or even check if it were prepared to see the occurrence of higher levels of unemployment than would be compatible with general Government policy or with public opinion.

Most prices of final goods nowadays and most standard wage rates are, as the phrase goes, "administered", i.e. are embodied in a formal announcement or a negotiated contract. But it seems to me most important to recognize that this is not in itself sufficient evidence that a rise in such a price or wage is the result of spontaneous or aggressive "push". It may be simply the institutional route through which a "pull" of increased monetary demand, itself due ultimately to a Government deficit or to a boom in private capital expenditure, makes itself felt; and this seems to me frequently to have been the case. In the words of one leading British expositor of this line of thought (F.W. Paish, London and Cambridge Economic Service Bulletin, September, 1961, p.xi.) "Wages do not rise at the whim of employers, or because the Trade Unions ask for increases, but because the demand for labour exceeds

the supply, and employers can pass on higher costs in higher prices without losing sales".

This being understood, however, it can I think be admitted that such a derivative cost-rise may come both to exceed in intensity and to survive in time the upswing in demand which set it in motion. And one factor promoting such a divergence of result from primary cause is the existence of systems of wage determination which communicate a wage increase automatically from one region or industry to others, without regard to whether the increase in the first centre is really exerting any "pull" on the labour attached to the others and so creating an economic justification -- as contrasted with a justification based on some vague and possibly obsolete conception of "fairness" -- for an increase in wages in those other centres.

Anyway for a Monetary Authority faced with a "cost push" -- whether spontaneous, derivative or mixed -- there may be a real and inescapable conflict between fastest possible <u>immediate</u> growth and fullest possible <u>immediate</u> employment on the one hand, and smallest possible divergence from the path of monetary stability on the other. But in this conclusion the word "immediate" is important; for the long run prospects of growth and employment may be gravely damaged by any serious lapse from monetary stability.

The degree of skill and courage which the Authority will need in order to make a good decision will vary according to the phase of activity in which the economy finds itself. If it is clearly over-extended, with prices rising smartly and unemployment at a very low level, no great skill and no superhuman courage should be needed to give the necessary temporary priority to the objective of stability over those of growth and employment; and whatever is said (and it may be a good deal) in the way of routine abuse, the Authority may be rewarded by seeing a good deal of the steam vanish out of the wage push simply as a result of the change of atmosphere and without the occurrence of those alarmingly high percentages of unemployment which some of its (self-appointed) economic advisors will probably have been predicting. In my judgment this is very much what happened in Britain in 1957-8.

More difficult, both intellectually and politically, is the task of deciding, after the sky has cleared a bit, how soon and how much the flow of money demand can be permitted to re-expand without setting the whole cost-raising process once more in motion. With every month that passes another slice of moderate opinion, both inside and outside the circles of Government, will probably be found moving over from the side of the congenital curmudgeons to that of the congenital gay-goers. I do not claim to know how to hit

the target, or even to know how to define the target to be hit. I incline to believe (as I have hinted a propos of the banks in § 8) that in Britain a tougher line in 1959 might have averted much subsequent trouble. More generally, it seems reasonable to hold that a tougher line is appropriate in Britain, where average unemployment has remained throughout at a level which is extremely low, than in Canada or the United States where it is still, for whatever combination of "monetary" and "non-monetary" causes, somewhat high. In all three countries there is room for measures to soften the edge of the dilemma by reducing the amount of unemployment, and by reducing still more the amount of distress from unemployment, associated with a given level of money demand. But here too delicate dilemmas may arise, not so much for Authority as for the individual employer, who will be liable to attack from one quarter if he is harshly swift to sack, and from another if he "hoards" labour which were better released to seek its fortune elsewhere.

12. Incomes Policy

It is not surprising that during the last year or two these dilemmas should have caused a number of Governments to reflect how agreeable it would be if their efforts to contain the flow of monetary demand could be met half way by agreed action on the part of employees not to demand, and of employers not to concede, wage advances on a

the target, or even to know how to define the target [illegible] I [illegible] (as I [illegible]) a propos of the [illegible] in 6 [illegible] in [illegible] a [illegible] line in 1949 might have [illegible] with [illegible]. [illegible], it seems [illegible] to [illegible] that a [illegible] line [illegible] appropriate [illegible], [illegible] [illegible] at a level [illegible] to [illegible] form. [illegible] in [illegible] on the [illegible] States [illegible] it is [illegible], for whatever [illegible] of "[illegible]" and [illegible] criteria, [illegible]. It [illegible] [illegible] [illegible] the [illegible] of the [illegible] [illegible] of [illegible], and [illegible] [illegible] [illegible] [illegible] [illegible] given level of [illegible]. But [illegible] [illegible] may [illegible] not [illegible] [illegible] for the [illegible] [illegible], who [illegible] be likely to [illegible] from one [illegible] [illegible] on [illegible] [illegible] [illegible] [illegible] [illegible] [illegible].

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It [illegible] [illegible] [illegible] [illegible] year [illegible]

scale which, if applied over the whole field, would cause the flow of money demand to rise faster than the national output. So far only in Britain among the major countries have these ideas been crystallized into a definite attempt to establish what is called a "national wages policy". I had better confess that I have never been an enthusiast for this course; but provided it is understood that it is intended as a supplement to, and not as a substitute for, direct manipulation of the monetary and fiscal machines, (Contrast such a statement as this of Mr. Kaldor (Economica, November, 1959, p.269); "All that is necessary is to recognize that the proper way of dealing with inflation is to damp down, or restrain, the rate of increase in money wages as such, instead of damping down the demand for goods and services" I am not prepared to regard it as fundamentally unsound; and during the past year I have felt it to be the duty of responsible persons in Britain to hope and work for its success.

But the difficulties are formidable. Of the two major ones, one has already raised its head in an acute form; for the Government, having designated 2½ per cent per year as a "guiding light" to the average presently practicable rate of increase, has thought it right to attempt (not in all cases successfully) to impose this rate on its own (direct and indirect) employees,

scale action, if applied over the whole field, would cause the flow of money demand to rise faster than the national output. So far only in Britain among the major countries have these ideas been crystallized into a definite attempt at [illegible] what is called a "national wages policy". I must confess that I have never been an enthusiast for this course, but I continue to be convinced that it is intended as a supplement to, and not as a substitute for, direct manipulation of the monetary and fiscal measures. [illegible] a statement at [illegible] of Mr. [illegible] (Economist, November, 1959, p.269). "All that is necessary is to recognize that the process of [illegible] wage inflation, as of late years, is [illegible], the rate of increase in money wages on [illegible] instead of merely [illegible] the output per [illegible] employee." I am not prepared to regard it as fundamentally necessary, and during the past year I have [illegible] to us the duty of [illegible] [illegible] to [illegible] work for the [illegible].

Are the [illegible] and [illegible],

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at the cost of disturbing those relativities between the rewards of public and private employment which is the longer run are likely to prove necessary for the adequate recruitment of the former. If the general policy is successful, this particular trouble should prove a passing phase; but the more general difficulty of finding any branch of activity willing to adopt a lower rate of wage-advance than the designated "average", and so to prevent the latter from becoming not an average but a minimum, is in my judgment likely to persist.

The other main difficulty is that of defining an acceptable "profits policy" for combination with the "wages policy" into a comprehensive "incomes policy". This difficulty has not yet become acute in Britain, for, comformably with what is recommended above, the wages policy has been inaugurated in conjunction with a credit squeeze, a pressure on profit margins, and a decline in stock exchange values which have made it difficult for the most hostile critic to attack it as an attempt to "do down" the worker for the benefit of the profit-maker; and that may become a more tempting line of attack as it becomes increasingly desirable for the Guiding Authority, in the interests of growth, to permit profit margins to re-expand. In that phase there is likely to be an increasing tendency to enquire whether there is not in the modern world an endemic tendency towards a

spontaneous "profits push", analogous to the alleged wage push, and calling perhaps for direct methods of intervention of the kind foreshadowed by President Kennedy in his dealings with the American steel companies. At that stage it will be most important to remember that, whatever may be true about wages and salaries (grade for grade), there is no reason to suppose that, from the point of view of economic efficiency, the rates of profit should, either in the short run or the long, be the same in different branches of economic activity, nor that the differences between them should be constant over time. And this is a consideration which perhaps imposes some further limitation on the usefulness of a single uniform figure of "guiding light".

At the moment of writing, political changes have rendered it uncertain in what directions the British experiment is likely to develop. All in all, I do not feel that it has yet achieved such a record of success that it can be confidently recommended for imitation in other lands. But so far I have felt that it deserves respectful watching as a courageous attempt to persuade free men to co-operate for their own good in eschewing lines of action which may otherwise lead to disastrous consequences for them all.

13. Commercial Policy

Disaster is a strong word; as a step towards justifying it let us at last throw open the frontiers.

Left to themselves, the citizens of any country will desire to enter into business relations with the citizens of other countries, buying and selling, lending and borrowing. Over a wide range any Government is likely to regard it as among its duties to smooth their path; but even a Government which attaches high value to the preferences of the individual and the processes of the market may think it right in the public interest to interfere with the scale of some of these transactions, stimulating some and retraining others, -- the whole complex of routine smoothings, special encouragements, and prohibitions or constraints,being welded together into a complicated but fairly coherent commercial policy.

Among the strands of such a policy some may be described as having their origin in concern over some particular commodity or group of producers. Thus a Government may limit the export of some scarce and exhaustible raw material, or the import of some sophisticated mechanical product for which it fears to become dependent on foreign skills. Thus also many countries have persuaded themselves that the welfare of their farming population is an objective of special importance, the consequent policy measures tending

in some cases towards an "unnatural" expansion, in others towards an "unnatural" contraction, in the volume of international trade. This is a huge subject, at which we need to do no more than glance. Here also fashions change, under the impact of events. In the 1930s even Keynes could write "Let goods be homespun whenever it is reasonably and conveniently possible;" in the fifties and sixties vast if patch progress, of which he would almost certainly have approved, has been made towards freedom of international trade in goods. In this development Canada has played an honourable part; may she soon be in a position to resume it.

14. Balance of Payments Policy

More closely relevant, I think, to the Commission's purpose is the fact that interferences even with current trade are often motivated by concern over the effect of unrestricted dealings on the capital position of the country in question, so that what appears as a "commercial policy" is really a balance of payments policy in disguise. Now a balance of payments policy may be of a less or a more ambitious kind. The less ambitious kind is confined to the avoidance or removal of what I will for the moment vaguely call "financial difficulties;" and many countries may well be content if they can achieve so much. But the more ambitious kind is concerned also with some desired state of the whole difference

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between the annual flow of current receipts from foreigners in payment for goods and services and the annual flow of current payments to foreigners for similar purposes. For just as a modern democratic country may become self-conscious about the rate of growth of its aggregate stock of wealth (see § 4), so it may become self-conscious about the rate of growth of that part of the stock -- positive or negative -- which lies outside its own frontiers.

A few examples will help to make this rather crabbedly phrased concept plain. It has long been a policy objective of the United Kingdom that the British people should earn a large enough current surplus overseas to enable it to make gradual repayment of some debts, to assist its kinsfolk in the development of their national estates, and to make some gifts and loans to the less fortunate peoples whose destinies have become entangled with its own. Much the same goes, *mutatis mutandis*, for the United States. The motives behind these policies may be a somewhat perplexing pot-pourri of profit, philanthropy and prestige, but they are not inherently ridiculous or discreditable. Conversely, it has till lately been the settled policy of Canada to acquiesce with a good grace in the desire of her neighbours, especially her rich and powerful neighbour to the south, to play an active and profitable part in the development of her estate;

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[illegible]

it has been her policy therefore to accommodate the sizeable "adverse balance of payments on current account" which has been the inevitable instrument for the accomplishment of that desire. This, too, seems in the past to have been a thoroughly appropriate policy, not justly open to attack as though it were the action of a drug addict who first lays in his stores of hashish and then mills around looking for cash with which to pay the bill.

But these "capital" policies, however sensible, may call for reappriasal in the light of changing events, lest they should conflict with more imperative requirements. The Commission may not be directly concerned with the reasons for which the two Lady Bountifuls mentioned in the last paragraph are having to take stock of their ways and consider which, if any, of their sacred cows must be led out to slaughter or at any rate put on half rations; but it is bound to be concerned with the repercussions of the stock-taking process on Canada, to whose troubles it has already added. For some years warning voices in Canada have been preaching that the time had come for her to do more of her saving for herself: and though the argument was sometimes overplayed, with inadequate distinction between the 5 billion dollars of debt and the 13 billion dollars of equity investment in foreign hands, it was impossible not to feel in one's bones that,

even from a strictly economic point of view, there was a good deal in it. Now what there was in it stands revealed. For while I think that histroically, as I have said above, the adverse balance of current payments is to be regarded as the result rather than the cause of the inflow of foreign capital, this seems to be another case (like the "push" of wages described in § 11 -- indeed it is perhaps another facet of the same story) where a "result" once established acquires an autonomous power of survival after the "cause" has been withdrawn or reversed. Thus for the designed capital inflow which has temporarily shrivelled away there has had to be hurriedly substituted first the "crisis" type of capital inflow which consists in the sale of reserves or emergency borrowing from private sources, and then the "rescue" type which consists of support from international agencies and friendly Government and Central Banks.

Perhaps what has been going on can be instructively put in this way. In Britain and the United States the desire to invest (in the broadest sense) abroad has tended to outlive the capacity to do so; in Canada the need to attract capital has tended to outlive the capacity to do so. It may seem a paradox that two such opposte conditions should produce, or threaten, the same result, namely an embarrassing shortage of ready cash. But is not the explanation that

e.g., from a strictly economic point of view. There was a good deal in it. Now what there was in [illegible] [illegible] revealed. For what I think that historically, as I have said above, the [illegible] [illegible] of current payments is to be regarded as the result rather than the cause of the rotation of circular capital, this seems to be another case (like the "push" of wages itself in [illegible]) -- indeed it is perhaps another facet of the same thing, where a "pattern" once established [illegible] [illegible] [illegible] power of survival after the [illegible] [illegible] [illegible] originally necessary. This [illegible] [illegible] current capital [illegible] which was frequently [illegible] [illegible] away [illegible] [illegible] to be [illegible] [illegible] [illegible] from the "original" type of capital [illegible] which consists in the sale of merchandise [illegible] [illegible] [illegible] from private sources, and then the "[illegible]" type which consists of support [illegible] [illegible] agencies and [illegible] [illegible] [illegible] [illegible].

[illegible] [illegible] [illegible] [illegible] [illegible] [illegible] tentatively put in this way. [illegible] [illegible] and the United States [illegible] [illegible] [illegible] the [illegible] [illegible] [illegible] [illegible] [illegible] the capacity to [illegible] [illegible] [illegible] the [illegible] current capital was [illegible] [illegible] [illegible] [illegible] so [illegible] [illegible] [illegible] [illegible] [illegible] opposite conditions could [illegible], [illegible] the same results, [illegible] [illegible] [illegible] or much [illegible] [illegible] [illegible] [illegible]

both conditions are manifestations of the same underlying malaise, -- the malaise of the bull-frog who wanted to grow faster than the laws of nature permit?

I am well aware that to many people this will seem a very shocking suggestion, since they are convinced that all our difficulties could be removed by a more liberal provision of international reserves, whether through a raising of the currency-prices of gold, a further extension of the powers and functions of the International Monetary Fund, or some combination of the two. Let me hasten to say, therefore, that I agree that there is a formidable problem of international reserves, or rather at least two problems, -- one of protecting the leading national currencies against the raids of speculators, and one of providing a reasonable annual increment in the base -- whatever it is to be -- of the world's monetary system. But I agree with Dr. Holtrop that these problems are most likely to be resolved with success if tackled in conjunction with policies "directed to preventing continuance of deficits and surpluses running into billions of dollars," (Report of Netherlands Bank for 1961, p. 19) -- or, in Dr. Roosa's words, "with heavy reliance on the discipline provided by the balance of payments." (Address to Conference of American Bankers Associations, Rome, June, 1962).

a [illegible] malaise, -- the malaise of the bull-frog who wanted to grow larger than the laws of nature permit?

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I do not believe countries have often been compelled to pursue for emergency balance of payments reasons courses of action very different from those which it would have been in their true long run interest to pursue for domestic reasons if they had realized it in time. There have been exceptions, doubtless, especially in the 1930s; I doubt if Canada in 1962 is a true exception, even if she is being compelled for a time to give a distasteful priority to monetary stability over the other "Rasminsky objectives".

15. Exchange Policy

I must add a few sentences, even if they be only in the nature of a funeral oration, on what was still, when I received the Commission's invitation to submit a memorandum, the most conspicuous feature of the Canadian financial system, the mobile rate of exchange. Having been engaged at a low level in the hammering out of that extraordinary document, the Articles of Agreement for an International Monetary Fund, to the framing of which Canadian wisdom made such notable contribution, I admit that I felt a kind of personal pang when in 1950 Canada saw herself obliged to run out of one of its leading provisions. But one had to remember that many other signatories were only managing to keep within the letter of the law by sheltering for far longer than had been anticipated in the "transitional" annexe; and one had to recognize

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15. Exchange Policy

I must add a few sentences, even if they be only in the nature of a funeral oration, on what was still, when I received the Commission's invitation to submit a memorandum, the most conspicuous feature of the Canadian financial system, the floating rate of exchange. Having been engaged at a low level in the hammering out of that extraordinary document, the Articles of Agreement for an International Monetary Fund, to the framing of which Canadian experts made such notable contributions, I admit that I felt a kind of unregenerate pang when in 1950 Canada saw [illegible] obliged to run out of one of its leading provisions. But one had to recognise that many other signatories were only [illegible] within the letter of the law by shifting [illegible] no longer [illegible] [illegible] [illegible]

Canada's peculiar difficulty in providing by any other means some kind of freedom of financial maneouvre vis-a-vis her all-powerful neighbour. One had to recognize, too, that she cast loose originally from strength and not from weakness, - not to evade the penalties of misconduct, but to give her people the legitimate real income advantages of a strong exchange position by a less devious method than the officially approved one of attracting scarce gold to serve as a basis for an engineered expansion of credit; while yet preserving for herself a relatively painless line of retreat if the wind should change. There are good economists who would say that that is just how these things ought always to be done, Bretton Woods or no Bretton Woods! Only, they would say, if the exchange rate is completely free to move can a virtuous country hope to pursue its own chosen blend of the "Rasminsky objectives" without risk of seeing it fatally contaminated by inflationary or deflationary poisons imported from abroad.

I think the balance of argument is against again attempting to make such a system work as between the major currencies of the world; in the end we should get tired of it, as we did in the later 1930s, and begin to make fumbling efforts towards tying up again. But I think it would be hard to show that the practice of this device by Canada between 1950 and 1960 did herself or anybody else much harm.

Canada's peculiar difficulty in providing by any other means some kind of freedom of [illegible]
[illegible]

One had to recognize, too, that one cast loose completely from sterling and not from everyone, - not to evade the penalties of misconduct, but to give her people the legitimate real income advantages of a stronger exchange position by a less devious method than the officially sponsored one of artificially scarce gold to serve as a basis for an enforced expansion of credit; while yet preserving for herself a relatively painless line of retreat if the wind should change. There are good economists who would say that that is just how these things ought always to be done, Bretton Woods or no Bretton Woods! Only, they would say, if the exchange rate is completely free to move can a virtuous [illegible] hope to pursue its own chosen blend of the 'fundamental objectives' without risk of seeing it fatally contaminated by inflationary or deflationary policies imported from abroad.

I think the balance of argument is against again attempting to make such a system work as between the major countries of the world. In the end we should get tired of it, as we did in the later 1930s, and begin to make tentative efforts towards fixing it again. But I think it would be hard to show that the practice of this device by Canada between 1950 and 1960 did much harm to anybody else. Much more

The last phase of the policy, the contrived depression of the exchange rate announced in the budget speech of June 1961 and put into effect during the succeeding months, is a trickier story, and I am not sure whether I have got it right, -- the Commission will be in a position to judge. It seems to me to have been the outcome of a correct judgment of what was required, combined with a (very naturally) erroneous forecast of what was going to happen. It was decided rightly that it was high time to make some attempt to reduce the adverse current balance; and since other ways of doing this were regarded as ruled out, it was held that it must be done by lowering the exchange rate, thus checking imports and encouraging exports. But it was expected that if left to itself the exchange would move, if at all, in the wrong direction, under the impulse of the continued inflow of capital; therefore this must be prevented from happening, and the pressure of the inflow of capital accepted in the orthodox form of an increase of reserves.

And thus indeed things happened until the end of the calendar year. But thereafter everything turned round. Of those two puzzingly intertwined snakes, the capital inflow and the adverse current balance, it was, as we have seen in § 14, the latter not the former which turned out to have the greater survival power. And in the last phase of all, a fixed rate of

The first effect of the policy, the controlled depression of the exchange rate engineered by the [illegible] in June 1931 and put into effect during the successive months, is a trickier story, and I am not sure whether I have put it right, — the Commission will be in a position to judge. It seems to me to have been the outcome of a general judgment of those [illegible] consulted, combined with a [illegible], about what [illegible] was going to happen. It was certainly [illegible] that it was [illegible] to make [illegible] the [illegible] and [illegible] other [illegible] of [illegible] this was regarded as [illegible]. It was said that it must be done by [illegible] the exchange [illegible] and [illegible] reports. It was expected that if left to itself the exchange would move, if at all, in the wrong direction, under the influence of the [illegible] inflow of capital [illegible]; this would be [illegible] from [illegible], and the [illegible] of [illegible] to the ordinary [illegible].

And these [illegible] until [illegible] the [illegible]. [illegible] the [illegible] which [illegible] to have the [illegible].

exchange came to look more like a home of refuge than like a prison.

I do not think it would be well to break out again. I expect it is a case of

And always keep a hold of nurse
For fear of finding something worse.

But there is no reason to regret the depreciation, which in the circumstances was rightly seen as part of what the doctor ordered. Only let there be care not to expect too much of it, or of the internal effects of the import taxes by which it has now been buttressed. For, if I may quote once more from the thirteen-year old talk cited in § 10,

> Depreciation is like a pill rolled in jam; a clever child will swallow the jam and spit out the pill. Purchase-taxes are like taking away, spoonful by spoonful, jam which has been solemnly handed over; a clever child will not forget, nor let you forget, that he once held the whole jar in his hands".

16. Coordination and Communication

This subject has two main aspects, -- the relations between Government and Central Bank and the relations between Central Bank and the other elements of the market. It is evident that in some periods in Canada both have left something to be desired. On the first, it seems to me impossible

exchange came to look more like a kind of refuge than like a prison.

I do not think it would be well to break out again. I expect it is a case of

And always keep a hold of nurse
For fear of finding something worse.

But there is no reason to regard the deprivation which in the circumstances was rightly seen as part of what the doctor ordered, — only let those who care not to expect too much of it, or of the personal efficacy of the largest forces by which it has now been buttressed. For, if I may quote once more from the forties-years-old talk cited in §10,

Legislation is like a pill coated
in jam; a clever child will swallow
the jam and spit out the pill
because there are like things
away, swallowed by spoonfuls, and
which has been solemnly counted over;
a clever child will not forget,
but let ... , that is once
said the rest ... in his mouth".

11. Conclusions and Comments

This subject has two main aspects, — the relations between the government and the general public, and the relations between the ... and the ... elements of the market. It is evident that in some respects the ... have ... more ... ed). On the other hand it seems to be impossible

to better the statement made by Governor Rasminsky on his appointment; and on the second too I have no doubt matters are now in better trim.

In both cases, it is a question of how much to attempt to tie up in legislative knots and how much to leave to the operation of good sense. That is a matter on which I doubt if the opinion of a non-Canadian academic would be worth much, even if he could find precise words in which to express it!

Cambridge,
July 28, 1962

Dennis Robertson